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FmHA LOAN SERVICING REGULATIONS AND A GAO REPORT ON FmHA'S FARM LOAN PORTFOLIO

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

JANUARY 30, 1986

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CONTENTS

Page

Helms, Hon. Jesse, a U.S. Senator from North Carolina, opening statement 1
Zorinsky, Hon. Edward, a U.S. Senator from Nebraska 3
Andrews, Hon. Mark, a U.S. Senator from North Dakota 4
Wilson, Hon. Pete, a U.S. Senator from California 6

CHRONOLOGICAL LIST OF WITNESSES

Crowley, Brian P., Senior Associate Director, Resources, Community and Economic Development Division, General Accounting Office, accompanied by Jim Wells, group director and Jim Yeager, evaluator 6
Naylor, Hon. Frank W., Under Secretary for Small Community and Rural Development, U.S. Department of Agriculture 31
Clark, Hon. Vance, Administrator, Farmers Home Administration, U.S. Department of Agriculture 36
Written questions from Senator Helms and Mr. Naylor's answers thereto 48

APPENDIX

Hawkins, Hon. Paula, a U.S. Senator from Florida, statement 55
McConnell, Hon. Mitch, a U.S. Senator from Kentucky, statement 56
Dixon. Hon. Alan, a U.S. Senator from Illinois, statement 57
Clark, Vance L., Administrator, Farmers Home Administration, U.S. Department of Agriculture, statement 57
Crowley, Brian P., Senior Associate Director, U.S. General Accounting Office, letter dated January 2, 1986, to Senator Helms, with attached report 59

FmHA LOAN SERVICING REGULATIONS AND A GAO REPORT ON FmHA'S FARM LOAN PORTFOLIO

THURSDAY, JANUARY 30, 1986

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The committee met, pursuant to notice, at 10:05 a.m., in room SR-328A, Russell Senate Office Building, Hon. Jesse Helms (chairman of the committee) presiding.

Present: Senators Helms, Cochran, Boschwitz, Hawkins, Wilson, McConnell, Zorinsky, Boren, and Heflin.

STATEMENT OF HON. JESSE HELMS, A U.S. SENATOR FROM NORTH CAROLINA

The CHAIRMAN. The committee will come to order.

This morning we meet to have testimony on the Farmers Home Administration relating to the condition of its farmer loan portfolio, as well as on its revised loan servicing regulations.

As we move into the agricultural lending season, it is appropriate to take a close look at the Farmers Home program and to consider the proper direction for this agency in the coming months.

Unfortunately, in past years, many have attempted to consider these issues only in terms of emergencies, and to attempt to whipsaw this agency for the short term, without deliberation of long-range implications.

This Senator believes that farmers are not well served by patchwork programs for credit assistance, or for that matter, any other areas that affect their livelihoods.

Our hearing this morning will address two obviously related issues. First, a comprehensive and objective overview of the Farmers Home farmer loan portfolio.

This past September, the Chair requested the General Accounting Office to conduct a study of the farmer loan program of the Farmers Home Administration and the financial condition of its borrowers.

The findings by the GAO were significant. Among other important data, I was stunned to learn that Farmers Home, in just the first 6 months of 1985, lent almost $800 million to borrowers who are insolvent, borrowers whose outstanding debts exceeded the value of their assets. We will examine this report and have a chance to question the GAO on its study.

The second issue to be addressed this morning is the recent modification and loan servicing regulations by Farmers Home. As I understand it, these regulations were intended to provide borrowers a clear and thorough explanation of the authorities available to help resolve delinquencies, and to clarify, that only after these servicing actions are determined to be ineffective in bringing each borrower current, would further action against that borrower be initiated?

Frankly, I have not been satisfied by the widespread misrepresentation of these regulations. Such erroneous information can only serve to foster needless confusion and stress for delinquent borrowers. Much of the hyperbole has been for partisan political advantage, and once again, the farmers are paying for it.

Therefore, the Chair hopes that this hearing will set the record straight, let the "chips fall where they may," on the loan-servicing policies of Farmers Home, and how they will be used, when possible, to assist viable borrowers to remain in business.

Now, we all share a deep concern for the stress so apparent in so many sectors of the agricultural economy. I support, and will continue to support responsible measures to assist farmers who have a reasonable chance for a profitable operation.

The Farmers Home Administration is the lender of last resort, and properly provides credit assistance to marginal farm borrowers who are not able to receive credit from private lenders. The credit title of the recently enacted farm bill contained several provisions which will provide Farmers Home with additional authorities to assist financially troubled borrowers, and I am proud of their efforts in that regard, and I am eager to hear from our USDA witnesses on the progress of the regulations to implement these provisions.

But, as most of us realize, some farmers are not going to make it. I do not like it; you do not like it; nobody likes it. It is unfortunate.

But any objective review of the situation must conclude that some farmers are hopelessly burdened with debt, and cannot be rescued, even with the most generous of programs, and, as I say, I believe we should do all we can do, responsibly, to help those farmers who are viable, and to assist in the transition to other livelihoods for those who are not.

The testimony of our USDA witnesses should indicate whether this will be the case in the coming months for those farmers who borrow from Farmers Home.

Farmers Home is charged with the responsibility of helping borrowers who pose the greatest credit risk—that is the intent of Congress—but this agency also has an equally important responsibility to use the taxpayers' money in an efficient and effective manner.

Therefore, our consideration this morning of the current policies of the Farmers Home pertaining to loan-making and servicing, together with an objective and comprehensive review of the condition of its farmer loan portfolio, which will provide information necessary to ensure that these objectives are accomplished. Senator Zorinsky.

STATEMENT OF HON. EDWARD ZORINKSY, A U.S. SENATOR FROM NEBRASKA

Senator ZORINSKY. Thank you, Mr. Chairman. I am pleased that we are holding these hearings on the loan-servicing regulations that were recently issued by the Farmers Home Administration.

In addition, I look forward to hearing testimony on the reports on Farmers Home Administration farm loan portfolio that the Government Accounting Office has completed.

The economic crisis in agriculture continues to be one of the most troublesome problems facing our Nation. The severity of the crisis is clearly reflected by the numbers of farmers and ranchers that are experiencing difficulty in repaying their Farmers Home farm ownership, operating, disaster, and economic emergency loans.

It is my understanding that as of September 30, 1985, there were 278,800 borrowers with outstanding Farmers Home Administration farm program loans totaling $28 billion; 28 percent of these borrowers were delinquent in loan repayments that totaled over $5.7 billion, and according to Farmers Home Administration officials in my State of Nebraska, farmers and ranchers held outstanding farm program loans of about $954 million. Repayment of almost $113 million of this amount was delinquent. Quite obviously, with such a high rate of delinquency, any precipitous action on the part of the Farmers Home Administration to liquidate delinquent loans would have grave consequences throughout the country.

Such action would result in the lowering of land values and thereby further undermine the financial stability of our farmers and ranchers, and their cooperative and commercial operators and creditors.

I would urge the administration to proceed with caution in this regard. When the Farmers Home Administration published its new loan servicing regulations, it appeared that the agency may have been planning to take immediate adverse action against a large number of its delinquent borrowers.

Subsequently, the agency has clarified that the number of borrowers who will receive adverse action notices will be limited.

In addition, the agency has recently explained that one of the primary purposes of the new regulations is to provide delinquent borrowers with an opportunity to work with the local Farmers Home Administration officials in attempting to correct loan defaults through restructuring of loans, deferrals of principal and interest payments, and other means. I believe that this is encouraging, but I remain seriously concerned that the local Farmers Home Administration offices may not have sufficient guidance or resources to adequately implement these new policies, at a time when there is a great increase in applications for Farmers Home Administration operating loans.

I am hopeful that today's witnesses would be able to explain, in detail, how the agency plans to implement the regulations and I look forward to their testimony and, in addition, I am hopeful that the GAO reports that are being made available to us today will be helpful to this committee in better understanding the nature of the high rate of default on Farmers Home Administration loans, and in that regard, I look forward to reviewing those reports and hearing the testimony of today's witnesses. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator. Senator Dixon, the distinguished Senator from Illinois, was here earlier and had to leave for the Senate Chamber because he has an amendment on the pending legislation there. He will return as soon as he can, and he asks that a statement that he has prepared be entered in the record.[1]

The CHAIRMAN. Senator Boschwitz.

Senator BOSCHWITZ. No opening statement, Mr. Chairman.

The CHAIRMAN. I thank the Senator. Senator Andrews.

STATEMENT OF HON. MARK ANDREWS, A U.S. SENATOR FROM NORTH DAKOTA

Senator ANDREWS. Yes, Mr. Chairman, briefly. I think it is critical that you are holding this hearing at this present time. I think it is going to be very helpful that we have the GAO report before us.

I would hope, Mr. Chairman, that in addressing the issue of Farmers Home Administration lending, when we look at these GAO books and we find the great number of loans that are in default, that that is not surprising to us, because Farmers Home, under the law, has been set up as the lender of last resort.

First, of course, you have your local banks. Second, you have your PCA's for operating loans, and your land banks for land loans.

Finally, you have, at the bottom of the totem pole, so to speak, the Farmers Home loan, and, when Commerce Department figures show us that the return on investment in agriculture is less than 2 percent, it is not surprising that the portfolio of Farmers Home is in trouble.

This is not because it has been maladministered, Mr. Chairman. It is not because farmers are ducking out. It is because there is no way, given today's interest rates, given today's farm prices, that farmers can make good on those loans when they have an average return of less than 2 percent on investment. We have a challenge on what to do, because those farm families, I submit Mr. Chairman, are a national resource.

It is not their individual problem. It is our problem, as a nation, to keep them out there producing the food and fiber we need for use domestically, and to share with a troubled world.

I think our agriculture production can be one of the strengths of America, if we are wise enough to use it in some of these other areas. The Soviets cannot produce this agricultural abundance.

Our challenge on this committee—and we met it in our farm bill—is to move toward a more export-oriented agriculture. In the meantime, we have to find ways of having Farmers Home be able to help those sincere farmers—not the ones who are cheating or slipping around the rules, and there are a few of those and I have no time for them and, Mr. Chairman, I am sure you have no time for them either.

But the farmer who is in debt through no fault of his own, but through an economic process, needs to be helped. I have a couple of problems with Farmers Home, and we brought it up in an earlier hearing we had in the Appropriations Subcommittee before we had these GAO reports.

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[1] See p. 57 for the prepared statement of Senator Dixon.

One of them, Mr. Chairman, quite candidly, was a statement that Secretary Naylor made some time ago, that they would accept no new customers. He assured us, Mr. Chairman, and I would be sure he would reassure this committee, that that statement is nonoperative. They will accept new farmer accounts, and that is highly necessary, as farmers cannot qualify for loans from their individual banks because the bank examiner comes in and classifies those loans.

They automatically drop down to Farmers Home. We need Farmers Home to pick those loans up.

Second, there are some strange tendencies in lending that have crept into the Farmers Home system, and this continues to concern me because, Mr. Chairman, I asked when they appeared last week about the loan practice where a farmer and his family come in for the disbursement of living funds. As you know they have a check made out, jointly, and they have to sign off and give that farm family in North Carolina, as they do in North Dakota, so much for their living expenses.

We have found that in some instances, Farmers Home administrative officers asked for the mortgage on the 1986 crops in order to give them 1985 living expenses.

Then, when they come to get their operating loan for 1986, they turn them down, and the farmer can go no place else. He has already signed away his crop mortgage for 1986, and he is between a rock and a hard place. Mr. Chairman, when I asked that question I was told that this is not a policy, this is not being done, but quite obviously, it is unfair, when you are disbursing 1985 living expenses, and that is part of your 1985 loan program, to take a mortgage on the 1986 crop without them entering into an operating loan for the 1986 crop.

I checked back home, and found out a number of specific individuals that have had that done to them by Farmers Home, and I would hope that in the course of these witnesses' testimony they would be responsive.

For example, Dwight Johnson of Menoken, ND, made an application for an operating loan for the year 1986. He was told that as part of his application he had to fill out a crop mortgage for 1986.

This was done in September—October 1985, and then he was in to see this attorney about 1 month ago, to say that his operating loan had been turned down.

The attorney then suggested to him that he try to get his crop mortgage back again, so that he can at least try for an operating loan from someone else. He was refused the return of that crop mortgage.

Mr. Chairman, that is not fair. That is not what Farmers Home is supposed to do. That is unthinkable. If an individual bank did it, they would be indicted, grabbing a mortgage for a crop that you do not make an operating loan on. It does not make any sense at all. Tim A. Williams of Cleveland encountered the same thing. He was told last summer that if he wanted to get living expenses he would have to sign a crop mortgage for 1986 with Farmers Home.

He did this in approximately July. This fall, he went in for operating money, and they said they would be willing to give him operating money, but in order to do this, he would have to give them a mortgage on all of his cattle, which presently are clear, and a few items of machinery. That made him very uncomfortable.

He knew about the audit, debt deficiency judgment statute. He asked for his crop mortgage back, which was again taken for the whole amount of the indebtedness, and they refused to give it back saying that they now had a mortgage on his crop for 1986, no matter what he did.

Mr. Chairman, those are totalitarian tactics and they do not fit in American agriculture. I know you do not support it as the chairman of this committee, and I would hope, Mr. Chairman, that we could get some answers from them today as to why they are doing that kind of thing in rural America.

The CHAIRMAN. I am sure the Senator will solicit those answers.

Senator ANDREWS. I will try, Mr. Chairman.

The CHAIRMAN. Yes, sir. Senator Wilson.

STATEMENT OF HON. PETE WILSON, A U.S. SENATOR FROM CALIFORNIA

Senator WILSON. Mr. Chairman, I just commend you. I think these hearings are extremely important. The difficult role that this agency has cannot be overstated, and in order for it to be as effective as it can, and in order for it to do so in the current atmosphere, when we are compelled to cut back on Government services and costs, it is going to require, I think, the most careful administration. I have confidence that the Administrator not only shares that view but possesses the capability to perform in that very difficult area. I think that these hearings can be of value to him, and certainly, to us, in understanding what it is that he faces.

It is an enormous challenge, and I doubt that it has been any more difficult at any time in the history of this agency.

I believe that this is one of the most important sets of hearings upon which this committee has embarked. Thank you.

The CHAIRMAN. I thank all Senators for their fine statements. We have two panels this morning, first, the GAO. I would suggest that they occupy the first three seats here. Brian P. Crowley, Senior Associate Director, Resources, Community and Economic Development Division, General Accounting Office, accompanied by Jim Wells, Group Director, and Jim Yeager, Evaluator. I appreciate your coming this morning, and you may proceed.

STATEMENT OF BRIAN P. CROWLEY, SENIOR ASSOCIATE DIRECTOR, RESOURCES, COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY JIM WELLS, GROUP DIRECTOR AND JIM YEAGER, EVALUATOR

Mr. CROWLEY. Thank you, Mr. Chairman. As you know, Mr. Chairman, your letter to us of September 6, 1985, expressed concern over the American farmers' growing reliance on the resources of the Farmers Home Administration, and you noted that Farmers Home's outstanding farm loan portfolio had increased from about $6 billion in 1978 to almost $28 billion in 1985.

With the Congress addressing this issue of financial stress in U.S. agriculture, including Farmers Home's future role in assisting farmers, you asked us to provide this committee with both national and State information on: Total farm debt and FmHA's portion of that total; total number of loans and borrowers and loan amounts for each of Farmers Home Administration's major farmer programs; and delinquencies and total losses occurring in these programs.

You also asked us to provide certain financial and general characteristics such as debtload, cash-flow, assets, liabilities, income, and the type and size of farm operations, and demographic data on FmHA borrowers. Mr. Chairman, as you might suspect, the financial condition of Farmers Home's loan portfolio and its borrowers is not a very pretty picture.

Individual debtload is high. A typical Farmers Home farmer is seeing shrinking equity, annual operating-cash shortfalls, and high debt-to-asset ratios, making many farmers technically insolvent.

Farmers Home, as an agency, is experiencing loan delinquencies in the billions of dollars. Loan losses are increasing, as evidenced by the almost doubling of losses from 1984 to 1985.

Farmers Home, at the same time, has responded to credit requests by substantially increasing its loan portfolio and trying to walk the extra mile with its problem borrowers.

New loans have been made to already technically insolvent borrowers who, in some cases, were seriously delinquent and might not be able to work their way out of these financial problems.

The result is a Farmers Home farm loan portfolio that contains a large number of loans that are highly susceptible to default.

Farmers Home estimates that about $14 billion, or about half of its $28 billion farm loan portfolio, is in jeopardy of default.

The information contained in our reports comes from our analyses of Farmers Home's automated data bases, and other Farmers Home and USDA records. Attached to my statement is a summary of the scope and methodology applied in our reviews.[2]

The remainder of my testimony discusses our two reports in more detail, followed by some observations. The first report I will discuss provides an overview of Farmers Home's loan portfolio.

As you know, the Farmers Home makes direct loans which are Government-funded, and guarantees loans made by private lenders primarily to family farmers who are unable to obtain credit from other lenders at reasonable rates and terms.

Our report provides information on Farmers Home's five major farmer loan programs: Ownership, operating, emergency disaster, economic emergency, and soil and water.

The financial condition of farmers and their lenders has deteriorated rapidly since 1980. As a result, increasing numbers of farmers have been turned down for financing by the private lenders and have come to Farmers Home for credit assistance.

Farmers Home has responded to these credit requests by substantially increasing its loan portfolio.

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[2] See pp. 59-79 for the material submitted by Mr. Crowley.

Total farm debt from all lenders more than doubled over the 10 years prior to 1985, growing from about $91 billion to over $212 billion. Over this same period, Farmers Home's farm debt increased over 400 percent.

As of June 30, 1985, Farmers Home's direct farm loan portfolio was almost $28 billion, consisting of about 270,000 borrowers with 757,000 loans.

The three largest loan programs are emergency disaster with $9.9 billion; farm ownership with $7.4 billion; and operating with $6 billion.

Farmers Home's growing farm loan portfolio is increasingly at risk because delinquencies are on the rise and loan losses are mounting.

Delinquent payments on Farmers Home's direct farm loans have risen from $164 million in June 1976 to $823 million in June 1980, to $6.4 billion in June 1985.

Almost $4 billion of the 1985 delinquencies are in one loan program, the emergency disaster program.

Mr. Chairman, I am going to be mentioning quite a few numbers here, and I have a schedule which may help you through this.

The $6.4 billion direct loan delinquent amount represents nonpayment of principal and interest due on over 97,000 borrowers' loans, with outstanding principal of $13.4 billion, almost half the total direct loan portfolio.

In addition, delinquent amounts would be much higher if Farmers Home had not made about 45,000 borrowers current during fiscal year 1985 without requiring full loan payments. Farmers Home accomplished this through servicing actions such as rescheduling/reamortization, and the setting aside of debt for later payment.

About $4.8 billion, or 75 percent of the June 1985 $6.4 billion direct loan delinquent amount, is owed by about 37,000 borrowers, who have not made a loan payment in over 3 years.

According to Farmers Home officials, borrowers over 3 years delinquent probably will not be able to catch up on their payments, and most likely will fail. Over $3 billion of this $4.8 billion is in the emergency disaster program.

For the past 10 fiscal years, annual Farmers Home farm loan losses, net of proceeds from sales of loan collateral, have grown from $24 million in 1976 to over $335 million in 1985 for direct loans, and from $963,000 to over $19 million for guaranteed loans.

Total annual farm loan losses increased over 400 percent between 1982 and 1985, growing from $82.6 million to $354.5 million, with the losses almost doubling between 1984 and 1985.

Cumulative loan losses for the past 10 years have been greatest in the emergency disaster, $492 million, and economic emergency, $238 million, programs.

Mr. Chairman, this report, the bigger of the two reports, contains a great deal of statistical information not only on the farm debt, delinquencies, and loan losses, but also, where this activity is located. Included in the report are a series of maps, tables, and graphs, which display the nationwide distribution of the statistics, and detailed State-by-State listings of loan activity.

I will now briefly discuss our second report, which analyzes the Farmers Home borrowers' financial condition.

Farmers Home acts as the Federal Government's lender of last resort and, as such, is expected to serve farmers under a high degree of financial stress.

Our analysis of the financial condition of individual borrowers highlights the seriousness of this financial stress.

A primary source of financial information on the borrowers was Farmers Home's farmer program information system, also known as the FARMS data base.

FARMS was designed to capture certain financial and other characteristics of Farmers Home's farm borrowers. Although FARMS does have some limitations, as discussed in the attachment to my statement, it is the most complete source of financial information available on individual Farmers Home borrowers. Farmers Home believes that this information is representative of all Farmers Home farmer program borrowers on a national basis.

In our report, we measured the financial condition of Farmers Home borrowers in the following ways: Debt-to-asset ratio; equity position; and cash-flow. The debt-to-asset ratio, which compares the value of a farmer's assets to the amount of money owed to creditors, indicates the farmer's overall financial soundness and risk-bearing ability.

According to USDA's Economic Research Service, at current prices, farming costs, and asset values, most farmers start having difficulties meeting principal repayment commitments at debt-to-asset ratios of around 40 percent.

Above 70 percent, farmers generally have problems meeting their interest and principal repayment commitments, and many start sliding toward insolvency.

The final critical point is insolvency where the total debts of the farmer exceed the total value of owned assets. At this point, a farmer generally cannot meet either interest or principal payments, and the value of assets, if sold, would not be enough to retire the debts.

Our analysis showed that the average FARMS borrower has a debt-to-asset ratio of 83 percent. About 20 percent of the FARMS borrowers are technically insolvent, with debt-to-asset ratios of over 100 percent, as contrasted with about 3 percent of all U.S. farmers reported in this category by USDA in January 1985.

An additional 31 percent of the FARMS borrowers are having extreme financial problems with debt-to-asset ratios of between 70 and 99 percent, while USDA classified 7 percent of all U.S. farmers in that category.

The FARMS borrowers we analyzed owed $8.1 billion, or about 30 percent of the entire loan portfolio. Our analysis of these borrowers showed that those classified as technically insolvent owed over $2.2 billion on 61,000 loans.

Other borrowers classified as having extreme financial problems owed an additional $2.9 billion on 81,000 loans. Thus, in June 1985, Farmers Home had over $5.1 billion outstanding on 142,000 loans to FARMS borrowers who were in extreme financial difficulty.

A farmer's equity represents the net worth of the farm operation, or stated differently, equity is the value of property owned above the amount of debt associated with it.

Our analysis showed that the average equity of FARMS borrowers is about $73,000. However, 20 percent of the borrowers have a negative equity, and an additional 8 percent have less than $10,000 equity.

A borrower's future equity position is greatly affected by the cash-flow of his farming operations. A shortfall in cash-flow can significantly erode a farmer's equity position.

Cash-flow statements provide information on the source of cash income, both farm and nonfarm, and indicate the farmer's overall ability to pay current production expenses, service principal and interest payments on farm debt, and provide for family living needs. Our analysis showed that the average FARMS borrower has a net cash shortfall of $56,000. The major contributor to this cash shortfall is the amount of annual debt repayment, $83,000, required from the farmer's total income, $110,000; 85 percent of the borrowers had a negative cash-flow.

The report also provides general characteristics of the borrowers such as type of farm operation; type, size, and number of loans; and personal characteristics.

As you can see, Mr. Chairman, these two reports paint a rather gloomy picture of the financial condition of Farmers Home loan programs.

In these difficult times, Farmers Home is faced with the dilemma of providing credit to high-risk farmers, while, at the same time, protecting the Government's, and ultimately, the taxpayers' financial interests.

The principal issue is: Where do you strike the balance? Where do you draw the line?

In February 1982, Farmers Home revised its servicing policy to assist farmers under extreme economic stress by allowing them to obtain additional farm loans without considering their ability to repay prior debts.

This policy allowed many farmers to stay in business. However, it also resulted in Farmers Home lending money to many farmers whose ability to repay was questionable.

For example, from the FARMS data we identified new loans totaling about $763 million made to 7,000 technically insolvent borrowers during the first 6 months of calendar year 1985.

Additional new loans, for $1.2 billion, were made to 12,000 borrowers with extreme financial problems. These new loans include the servicing of existing debt, and thus not all of the $1.9 billion is new money.

In addition, although FARMS borrowers we analyzed represent only 30 percent of all borrowers, FARMS borrowers in extreme financial difficulty owed Farmers Home over $5.1 billion as of June 1985.

With more of its farm loan portfolio at risk, Farmers Home issued a policy directive in November 1985 that requires a borrower to be current on loan payments before additional credit will be provided.

To help borrowers bring their loans into a current status, Farmers Home offers a variety of servicing alternatives, such as payment deferment and the consolidation, rescheduling, and reamortization of loans.

Much concern has been expressed in the media, and by Members of the Congress about the appropriateness of Farmers Home's actions.

As you can see, Mr. Chairman, Farmers Home does not have an easy task in finding an appropriate balance between acting as the lender of last resort for farmers who cannot get credit elsewhere, while at the same time, protecting the Government's financial interests through sound loanmaking practices.

Mr. Chairman, I have attached to my statement a series of maps, charts, and graphs from these two reports. This information highlights the results of our analysis.

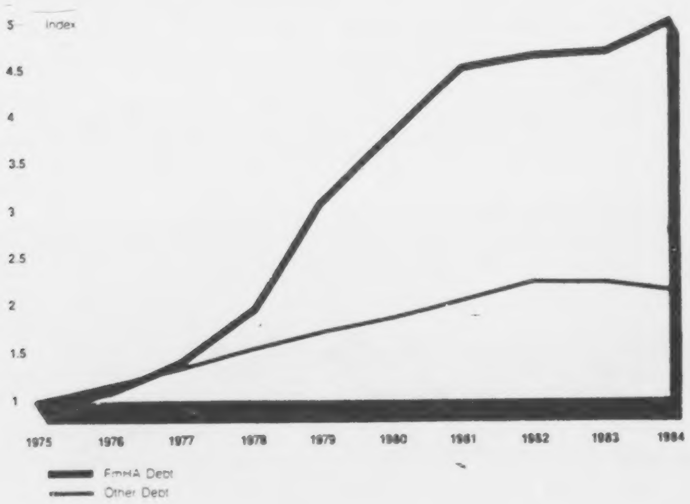
SCOPE AND METHODOLOGY

The information contained in our two reports comes from FmHA automated data bases and other FmHA and USDA records. We did not test the validity or reliability of this information. We obtained overall farm debt information from various reports issued by USDA's Economic Research Service. We developed FmHA farm debt information, including delinquencies, from FmHA's master borrower file and loan status reports. Loan loss data came from USDA budget records. We conducted our own computer analysis and developed programming and format methodologies to single out and specifically report on FmHA's five major farmer loan programs: Farm ownership, operating, emergency disaster, economic emergency, and soil and water.

The primary source of financial information on the borrowers was FmHA's farmer program information system, also known as the FARMS data base. FARMS was designed to capture certain financial and other characteristics of FmHA's farm borrowers. We obtained a July 1, 1985, copy of this data base, which was started by FmHA in 1983. We conducted our own computer analyses of the data and identified 66,000 individual borrowers who had received 117,000 FmHA farm loans during 1983 and 1984. We sorted, tabulated, arrayed, and averaged financial information on these borrowers using various production, sales, debt, asset, and personal characteristics. Although FARMS does have some limitations, it is the most complete source of financial information available on FmHA borrowers. FmHA believes that this information is representative of all FmHA farmer program borrowers on a national basis.

We obtained agency comments on the results of our work, and the agency agreed with the information contained in the reports. The comments provided were incorporated in the reports where appropriate.

Figure I.1: Index of Farm Debt, December 31, 1975-1984



Index Base Year 1975 = 1

Table I.1
FmHA and All Other Farm Debt
(December 31, 1975-1984)

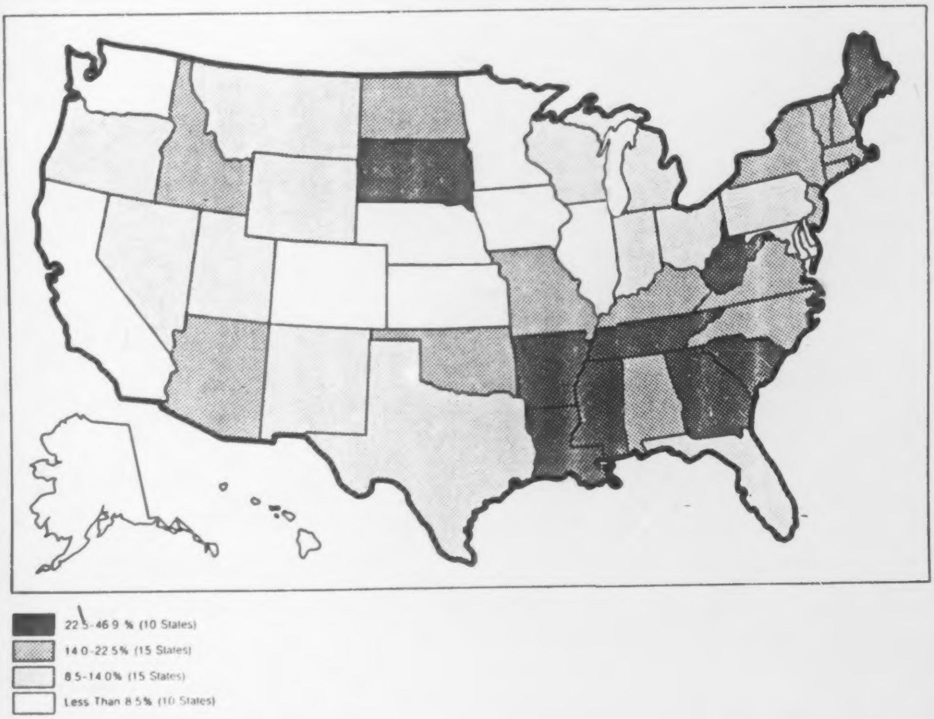
Year	FmHA farm debt (billions)	Index of annual change[a]	All other farm debt[b] (billions)	Index of annual change[a]	Total farm debt
1975	$ 5.1	1.00	$ 86.5	1.00	$ 91.6
1976	5.5	1.08	98.5	1.14	104.0
1977	7.1	1.39	115.9	1.34	123.0
1978	9.9	1.93	131.2	1.52	141.1
1979	16.1	3.13	150.0	1.73	166.1
1980	19.5	3.79	162.9	1.88	182.4
1981	23.2	4.51	178.9	2.07	202.1
1982	23.8	4.64	193.4	2.24	217.2
1983	24.1	4.69	192.1	2.21	216.2
1984	25.7	4.99	186.9	2.16	212.5

[a] Index: Base year 1975 = 1; index calculations based on whole numbers.

[b] Excludes FmHA farm debt.

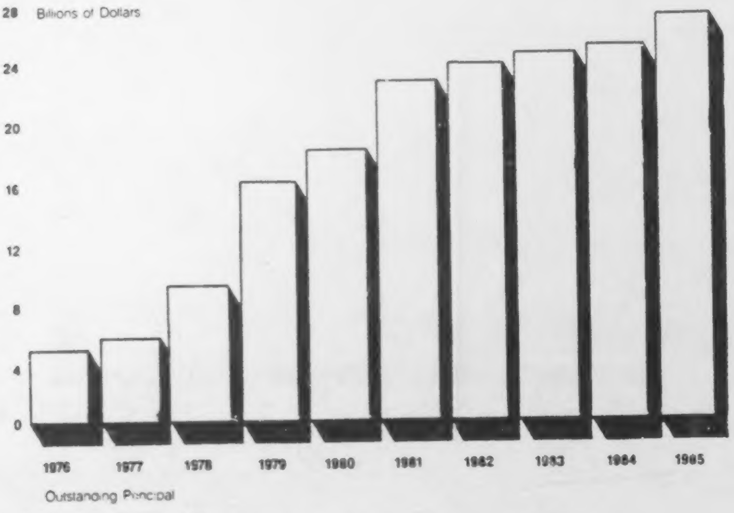
Source: GAO/RCED-86-57BR--January 1986.

Figure I.4: FmHA Farm Debt as Percent of Total Farm Debt--Nationwide Distribution, December 31, 1984


22.5-46.9 % (10 States)
14.0-22.5% (15 States)
8.5-14.0% (15 States)
Less Than 8.5% (10 States)

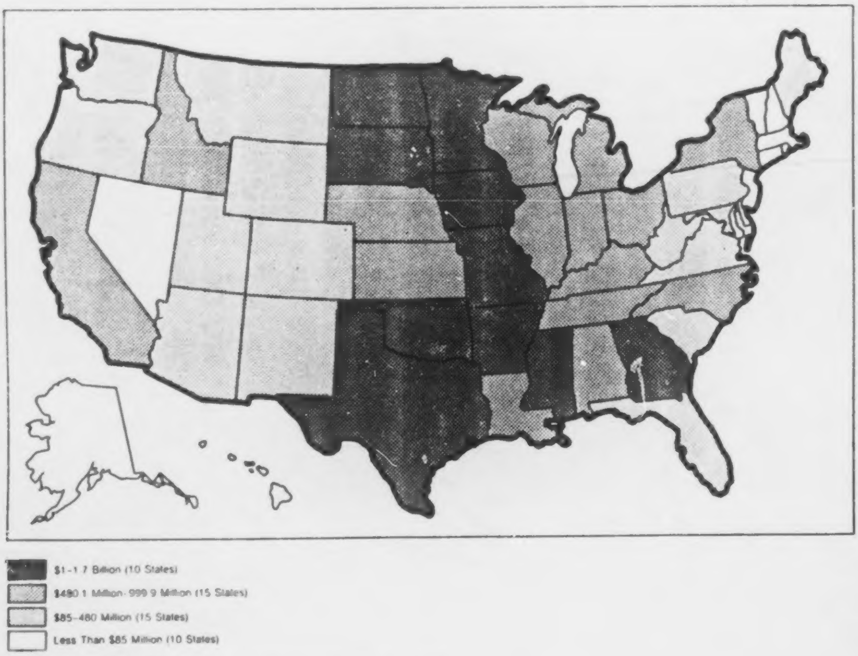
Source: GAO/RCED-86-57BR--January 1986.

Figure II.1: FmHA Major Farmer Program Outstanding Principal--Direct Loans, June 30, 1976-1985



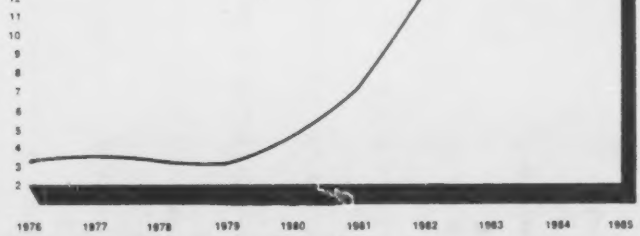
Source: GAO/RCED-86-57BR--January 1986.

Figure II.6: Total FmHA Major Farmer Program Outstanding Principal, Direct Loans--Nationwide Distribution, June 30, 1985


$1-1.7 Billion (10 States)
$480.1 Million-999.9 Million (15 States)
$85-480 Million (15 States)
Less Than $85 Million (10 States)

Source: GAO/RCED-86-57BR--January 1986.

Figure III.1: FmHA Major Farmer Program Delinquencies as a Percentage of Outstanding Principal, June 30, 1976-1985



Source: GAO/RCED-86-57BR--January 1986.

Figure III.2: FmHA Major Farmer Program Delinquent Dollars, June 30, 1976-1985

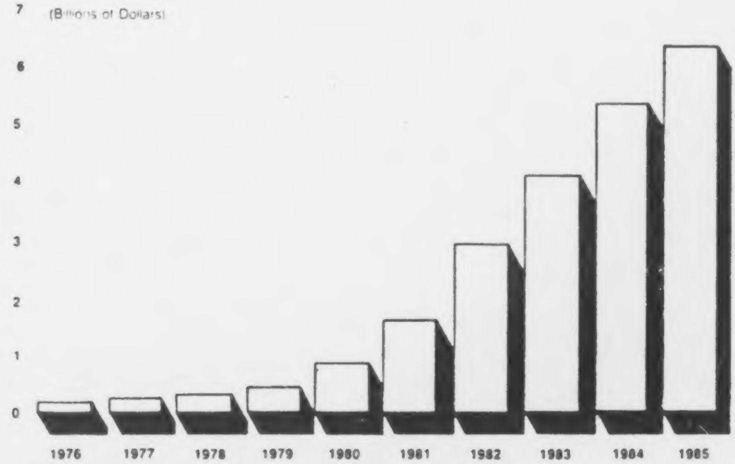
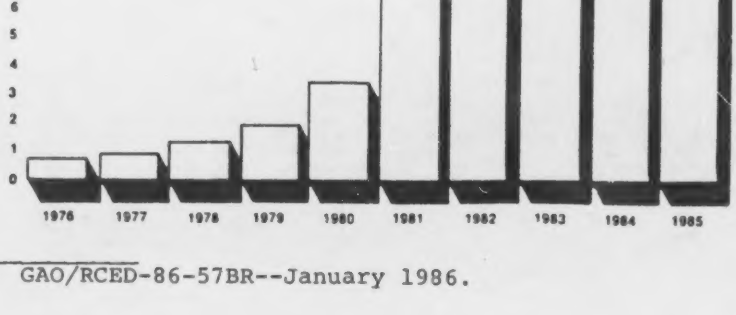
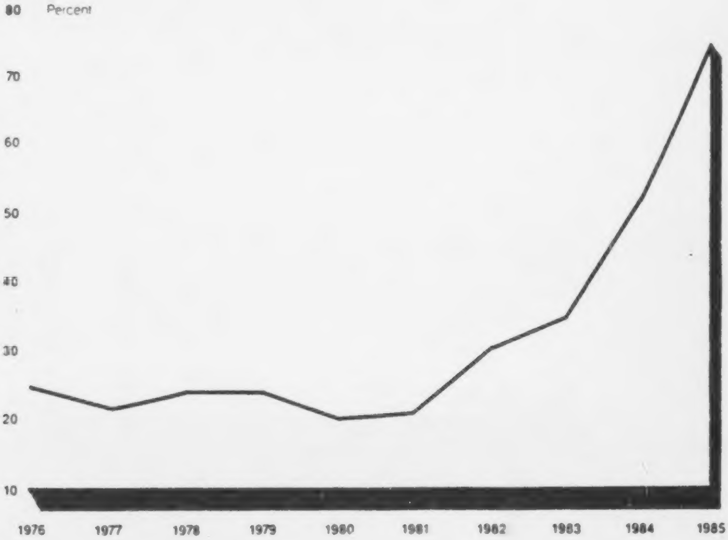


Figure III.3: FmHA Major Farmer Program Outstanding Principal on Delinquent Loans, June 30, 1976-1985



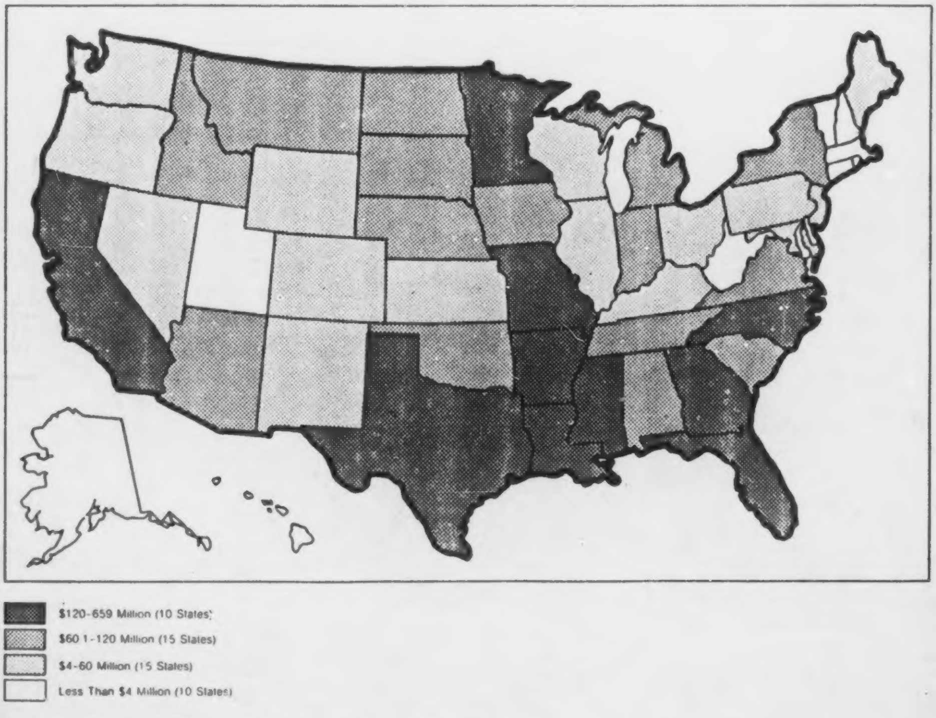
Source: GAO/RCED-86-57BR--January 1986.

Figure III.4: Percent of FmHA Major Farmer Program Dollars Delinquent Over 3 Years to Total Delinquent Dollars, June 30, 1976-1985



Source: GAO/RCED-86-57BR--January 1986.

Figure III.13: FmHA Major Farmer Program Dollars Delinquent Over 3 Years--Nationwide Distribution, June 30, 1985


$120-659 Million (10 States)
$60.1-120 Million (15 States)
$4-60 Million (15 States)
Less Than $4 Million (10 States)

Source: GAO/RCED-86-57BR--January 1986.

Mr. **Crowley**. In addition, the GAO has done a great deal of work, recently, that deals with the financial stress in agriculture overall.

I have attached, for your information, a list of the reports that address various issues related to the financial and economic condition of the agricultural sector.

That concludes my statement, Mr. Chairman. We will be glad to respond to any questions.

The **Chairman**. It was a very fine statement. While you were delivering your prepared text, which I had seen earlier, I was looking at some of the addenda which are very interesting, and I think that the Senators will want to study this.

Each Senator has before him a copy of these two documents. One addresses itself to the "Financial and General Characteristics of Farmer Loan Program Borrowers," and the other is "An Overview of Farmer Program Debt, Delinquencies, and Loan Losses."

Now I have been around this place a while, and I find myself unable to recall that the GAO has ever made a report of this sort before. Am I correct?

Mr. **Crowley**. You are correct that we had not made a report on the loan portfolio in a way that arrayed information regarding individual borrowers. That data had not been available until Farmers Home started to develop the FARMS system, which allowed us to make that kind of analysis.

The **Chairman**. Well, in any case, it is certainly helpful and it gives us the perspective, which is enormously helpful to me.

I think probably we ought to start the timeclock, and count mine as having expired at least 1 minute, and let's take the first round of 5 minutes, because we have Farmers Home Administration officials here, and I expect that the Senators will want to have at them before it is over. So ring the bell on me when I run out of time.

I would say to you, that it is clearly the intent of Congress that Farmers Home provide credit to borrowers who pose the greatest credit risk.

However, having read and heard your statement, and looked at some of the data, it appears that many loans in 1985 were made to borrowers who have no reasonable hope of making repayment. As a matter of fact, you stated that quite clearly.

Now, based on your knowledge of the Farmers Home programs, what is your assessment of the current direction of Farmers Home lending policies in relation to congressional intent?

Mr. **Crowley**. Well, as I understand it, Farmers Home now intends to use all of its authority to assist borrowers to continue farming, if there is a reasonable chance of success, that they can repay past debts, and be able to take on new loans.

The congressional intent seems to be that loans would be secured and that loans would be repaid. I think that until we see how Farmers Home implements its present policy, I would have a problem directly commenting on it, but offhand, I would say that at least it seems to be a step in the right direction, in that they are trying to address the delinquency problem directly.

The **Chairman**. Well, you did look at the portfolio on lending practices during the first 6 months of 1985, didn't you?

Mr. CROWLEY. We did look at what happened. We did not make an evaluation of the lending practices.

The CHAIRMAN. Well, I need to ask you, just the same, in your judgment, if Farmers Home continues these practices in the future, what impact would it have on, first, the farmers, and second, the Government, meaning the taxpayers?

Mr. CROWLEY. Our data shows that the FARMS borrowers that we looked at had a net, cash shortfall of $56,000. It also has another average figure—you can't really add or subtract averages—but there's another figure that shows that the average borrower had about $73,000 in equity.

Continuing with some of these borrowers, if there is not a chance that they will be able to repay the loans, can hurt in two ways. One is that the equity position will continue to erode, and the second is that the Government may not get its money back.

The CHAIRMAN. Now you said that your study shows an inordinately high percentage of delinquencies in the emergency disaster loan program.

Mr. CROWLEY. That is true.

The CHAIRMAN. Does your data indicate why?

Mr. CROWLEY. No; we did not look into that, Mr. Chairman. We do know that it was one of the big items. In fact I had it as a separate category in the handout I had given you earlier.

The CHAIRMAN. Right.

STATUS OF FmHA LOAN PORTFOLIO AS OF JUNE 30, 1985

[In billions of dollars]

	Total	Emergency disaster
Total principal owed on major farm loans	28	9.9
Delinquent payments	6.4	3.9
Principal owed by delinquent borrowers	13.4	6.7
Payments owed by borrowers who have not made a payment in 3 years or more	4.8	3.0

Mr. CROWLEY. I think Farmers Home may be able to address that. I do know that the loans in that category are large, and that they are at relatively low interest rates, between 5 and 8 percent.

You could speculate, that if someone is financially stressed, the first debt that an individual will pay off will be a loan that carries a much higher interest rate, and so it might be—and I am just speculating—that that may be the reason why these particular loans are that far delinquent.

The CHAIRMAN. I operate that way myself. I have got a low-interest loan——

Mr. Crowley. So do I.

The Chairman. And I do not have a low-interest loan any more. Farmers Home is currently implementing some new servicing regulations. Do you have any information on how these new policies will affect the loan portfolio and individual borrowers?

Mr. Crowley. No. I do not; not directly. But Farmers Home apparently is going to continue lending money to at least those borrowers who they feel can make it, even after they go through a series of rescheduling and reamortization and deferral.

It seems to me that Farmers Home is addressing the problem and trying to work it through. I do not really have any information on how that might affect policies in the future.

I think you can guess that some people are going to go out of farming; others will not. Others will be able to reschedule their debt, make some changes, sell off some assets, make themselves current, and continue in operation.

The Chairman. Now your report indicates that the average farm borrowers have a net worth of what, $73,000?

Mr. Crowley. Yes.

The Chairman. If Farmers Home should revert back to last year in its lending and servicing policies, would this further erode the equity position of many of these borrowers?

Mr. Crowley. It could if prices do not turn around, if the economic situation stays the same. If the borrowers that have a negative cash-flow are not going to be able to turn that situation around, it will have an effect on equity and equity will erode.

The Chairman. Then you would conclude it would be in most borrowers' best interest to make loans based on repayment ability rather than net worth, to avoid the needless erosion of their equity?

Mr. Crowley. Well, I think you make a pretty good point but I would like to change that around just a little bit. You know, in the 1970's, many banks got into trouble by loaning money strictly on the basis of equity, loaning on the basis of inflated land values, for example. That got us into a lot of trouble.

Today, if we switch completely around to something else and say it is on repayment ability, remember, repayment ability is always going to be based on what kind of price a farmer is going to be able to get at a particular point in time in the future.

I think you need to consider both, but I think repayment ability definitely has to be a major factor in considering whether you are going to continue with a borrower.

The Chairman. One final question on my round. I am amazed that the 5 minutes is not up. I have a bunch of questions. The GAO numbers on the extent of delinquencies, given these numbers, dc you feel that the eligibility requirements to obtain Farmers Home loans should be reconsidered?

Mr. Crowley. I really cannot comment on that, Mr. Chairman. I did not take a look at the eligibility requirements from that particular standpoint.

The Chairman. Senator Zorinsky.

Senator Zorinsky. Thank you, Mr. Chairman.

Mr. Crowley, based on your analysis, do you think things are getting worse or improving? In short, where do you think we are headed?

Mr. Crowley. I think, Mr. Zorinsky, that we have a problem that we have to address in terms of large delinquencies now. We need to do something about that now. I do not know where we are going to be at the end of 1986.

A lot of things could happen between now and then. Exports could improve; prices could advance. I cannot predict that.

Senator Zorinsky. If commodity prices do not improve, where will we be?

Mr. Crowley. I think we are going to get worse, but that is my personal opinion.

Senator Zorinsky. I understand, according to your analysis, you found that 20 percent of the Farmers Home Administration farmer program borrowers are technically insolvent, and another 31 percent had difficulty making principal and interest payments on their loans.

In my judgment, any action to liquidate a large number of loans could adversely affect an already fragile economy. In other words, a large number of liquidations would trigger an additional erosion in the value of land. Too, I do not think the Government really wants to get into the farming business—operating farms and holding real estate. That costs money, too.

Mr. Crowley, how would you recommend that the Farmers Home Administration handle this situation? Something needs to be done. In my opinion, the answer is higher commodity prices. Then we would not have to hypothesize on any of this.

Mr. Crowley. You are right. What you are dealing with is a situation where agriculture is very much impacted by factors much beyond its control. When Secretary Block announced his resignation, he made the point that one of his frustrations in this town was that there were so many factors that affected agriculture that he had no control over. When you deal with things like—the Government not really wanting to get into the business, as I understand it, of being a large farm owner. Not many years ago, Farmers Home only had about 200 properties nationwide. I think if you count now, the number of properties is up to around 4,000.

And that is not from, necessarily, Farmers Home foreclosing. It is either voluntary conveyance, or someone else foreclosing, and Farmers Home picking up the asset because it is literally forced to.

It is a tough dilemma. The one thing we have now is a large amount of delinquencies. We have several different options that we can offer farmers on how to make them current.

I think we should start by trying to save those that we can. We also have a limited amount of resources that we can put into the farm sector.

But we should be working with the farmers that we think have a good chance of making it.

Senator Zorinsky. Where would you draw the line on debt—those who can make it and those who cannot? Obviously, everybody thinks they can make it. But is it in the area of debt-to-asset ratio? Is it the area of cash-flow? Or is the best approach to proceed on a case-by-case basis?

Mr. CROWLEY. The first thing I think you have to look at is cash-flow. Can somebody make it on cash-flow this year? The chairman asked me before a question of, when you make loans should you only consider cash-flow?

When you make loans you have to consider collateral, too. So, I would say yes, you have to consider collateral, or net worth also.

Right now, when you are talking about delinquencies and whether you are going to help someone, the first decision should be, is this individual going to be able to make it in terms of cash-flow, or is the cash-flow going to be negative again?

Senator ZORINSKY. Would a 50-percent advance in deficiency payments for the 1986 crops make the difference between "yes" or "no" on cash-flow?

Mr. CROWLEY. I do not know. What you really have here, and I think it was pointed out earlier, was that you have the county Farmers Home person working with the farmer. How well that might work across the country depends on the individual—you are always going to find glitches. You are not going to have it work perfectly every place; but it has to be on an individual basis.

It has to be the individual county supervisor working with the farmer, to see if there is a way that the farming operation could be changed, and what changes can be made to the individual debt that the farmer has. What are his prospects of turning a situation around?

Senator ZORINSKY. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Cochran.

Senator COCHRAN. Thank you, Mr. Chairman. Mr. Crowley, I was wondering, in response to one of the questions posed to you by the chairman with respect to Farmers Home's policies of restraint, or forbearance, whether you took into account the fact that the Farmers Home Administration has been under the restrictions of a court order for the past 2 years.

What impact do you think the expiration of the effective date of the court decision has on the Farmers Home in its opportunity to collect delinquent loans?

Mr. CROWLEY. I think the expiration of that order means that Farmers Home can now work with delinquent borrowers. Yes, we did take that into consideration.

There has been a 2-year moratorium on any action taken by Farmers Home against delinquent borrowers. But I think now you have a pretty bad problem in that half of the portfolio is delinquent.

I think we need to work with those people who are delinquent, to try to work with those that can make it, and some are going to fail.

Senator COCHRAN. There continues to be litigation involving the Farmers Home Administration. At hearings that our Appropriations Committee had last week, there were some Senators who brought up the fact that in the State of North Dakota, I think, there is current litigation underway.

What assessment, if any, have you made about the possible impact on the flexibility that Farmers Home is going to have with respect to the constraints of this continuing litigation?

Mr. CROWLEY. I do not know what the effect of the continuing litigation is. I know that the other litigation, the one which just expired, did hold Farmers Home back from dealing with possible foreclosures for 2 years. But I cannot speculate on what this current litigation would do. Mr. Naylor may be able to do that for you.

Senator COCHRAN. But as I understand the thrust of your report, your assessment is that farmers who have borrowed from Farmers Home Administration are in terrible financial shape, but the fact of the matter is that a person who goes to the Farmers Home Administration, at the outset, is in terrible financial shape. Is that not true?

Mr. CROWLEY. That is true. In fact my statement recognizes that, Senator. It says in the report that we realize that Farmers Home has to deal with a borrower who has been turned down elsewhere; but what we try to do is show you a series of facts as to just how stressed these people are.

Senator COCHRAN. Have you attempted to do any analysis of the impact on the economy in these areas, if Farmers Home goes in and forecloses on all delinquent borrowers?

Mr. CROWLEY. No, sir. We did not.

Senator COCHRAN. I notice that in your assessment, though, of the total amount owed to Farmers Home, and just looking at my State of Mississippi, over $1 billion in outstanding indebtedness to the Farmers Home Administration in the State of Mississippi.

Now, I do not know what the ratio of that debt is to total farm assets, but I would expect that it would be pretty high, so that if foreclosures were to occur on all delinquent borrowers in my State, I think the impact on the economy would be to wipe it out.

So, I think even in spite of the suggestion in the report that Farmers Home ought to maybe be more aggressive in collecting these delinquent accounts, or forcing liquidations—if I am not misunderstanding the thrust of some of your comments—I am afraid if they took your advice, you would just ruin the economy in a lot of States.

Mr. CROWLEY. Senator, I am going to take exception to what you said because we do not say that. What we do imply is that Farmers Home should work with delinquent borrowers to get them current. There is no suggestion, obviously, that anybody be forced into liquidation, or that whole communities go down the tubes. That is not going to help either Farmers Home, or the farmers themselves. I think the suggestion is that we have a very bad delinquency problem here and that we need to work with it. We need to work on that problem.

Senator COCHRAN. I am glad to hear that because in just looking over the comments in your testimony, and the thrust of the GAO investigative report, I got the impression that there was a suggestion that Farmers Home Administration ought to be tougher, and go after these delinquent loans in a more aggressive way.

But I am glad to hear that it is your assessment that it is not necessarily bad that Farmers Home exercise some restraint and flexibility and try to work with farmers on a case-by-case basis. Is that correct?

Mr. CROWLEY. That is right.

Senator COCHRAN. One other question that I was going to ask, and that is whether the next step might be to implement some provisions of the recently passed farm bill, where there are incentives provided for taking out of production some of these marginal lands, lands that probably ought never to have been put into cultivation, and instead, transferring those into use for wildlife habitat, or some other use, other than row crop farming that has led some of these farmers down to the depths of economic chaos that they find themselves in now. Was there any assessment made of recently passed provisions, and how they may be used to help achieve a better goal? That is, rather than foreclosing and just putting this land up for sale on the market; causing it to continue to be planted to row crops; that we just take some of that land out, enter into an easement relationship with the Government, forgiveness for some of these loans, if the land will be used in a different way in the future.

I am hoping that maybe we could see that kind of reaction, instead of just foreclosure, taking the land away from these farmers, and these families. What is your reaction to that?

Mr. CROWLEY. My reaction, Senator, is that obviously Farmers Home needs to work with the borrowers, and one of the tools that it has to work with borrowers, right now, is the new farm bill.

Now, we did not do an analysis of the farm bill and its impact on Farmers Home. The purpose of the two reports is to lay out what the problem is.

Once the problem is recognized, once people want to sit down and work it out, that is when you start coming up with solutions that everybody can buy.

Senator COCHRAN. Thank you. I thank the chairman.

The CHAIRMAN. Thank you, Senator Cochran. I believe Senator Heflin left. I would have called on him. Senator Boschwitz.

Senator BOSCHWITZ. May I ask what you mean by the term "loan delinquencies, loan losses," and so forth? You used a number of terms. Have you graded the various delinquencies, whether they are short term, long term? Is that in this report, too?

Mr. CROWLEY. We have graded some in terms of who has not made a payment in 3 years and the dollar amounts.

Senator BOSCHWITZ. That is in there?

Mr. CROWLEY. That is in there.

Senator BOSCHWITZ. 37,000.

Mr. CROWLEY. Yes. When we talk about delinquencies, we took the figures as of June 30, 1985. If an individual had not made a scheduled payment at June 30, 1985——

Senator BOSCHWITZ. A scheduled payment.

Mr. CROWLEY. Right. He was probably already 6 months delinquent. Most Farmers Home bills are due January 1.

Senator BOSCHWITZ. So did you grade the delinquencies, whether they had missed one payment, two payments, three payments? Was that done in any part of this report?

Mr. CROWLEY. I do not know if it is done exactly that way. Let me turn it over to——

Senator BOSCHWITZ. When did you evaluate the delinquencies in that case?

Mr. CROWLEY. If they had not paid——

Senator BOSCHWITZ. How do you evaluate them? I mean, a guy who is delinquent for——

Mr. CROWLEY. Well, Senator, if a man does not make a payment, he is delinquent.

Senator BOSCHWITZ. Well, I know, I know; but if a man does not make a payment, it is a lot different than if he has not made two, particularly if they come on a semiannual basis.

Mr. CROWLEY. Well, the payments usually are annual, and——

Senator BOSCHWITZ. If he has not—let me repeat it, then—if he has not made one payment, if he has missed one payment, it is a lot different than——

Mr. CROWLEY. That is true.

Senator BOSCHWITZ. If he missed two, or three, or four, particularly, is not that true?

Mr. CROWLEY. That is true.

Senator BOSCHWITZ. Do you have any type of data on that?

Mr. CROWLEY. We have data that shows how many have not made a payment in 3 years, as I said; no payment at all. In fact that was on that little schedule that I showed you.

Senator BOSCHWITZ. Sure. I saw that.

The CHAIRMAN. These are annual payments. They are not like I make a payment on a house every month.

Mr. CROWLEY. Right.

Mr. WELLS. That is correct, Mr. Chairman. There is an analysis in the GAO report that lays out a table, that breaks the borrowers down, 1 year, 2 years, and 3 years, and more. Yes, sir.

Senator BOSCHWITZ. What is the percentage of delinquencies within 1 year, 2 years, 3 years?

Mr. WELLS. Yes, sir. Those percentages are here in the report. I can pull them out for you, if you would like.

Senator BOSCHWITZ. Why don't you do that.

Mr. WELLS. Yes, sir.

Senator BOSCHWITZ. You say here that the FmHA is trying to walk the extra mile with its problem borrowers. Of course the FmHA is subject to a great deal of criticism because of—as you know—they have foreclosed, and they are the lender of last resort, so they start off with the worse borrowers.

Would you characterize, in your judgment, analyzing the portfolio, and their activities, have they really walked the extra mile, and are they making an effort to accommodate said borrowers?

Mr. CROWLEY. That was our judgment, based on several reviews, not only this one, and yes, we feel that way, that they have been walking the extra mile.

Senator BOSCHWITZ. In which way?

Mr. CROWLEY. They rescheduled 45,000 borrowers. We state that in the report. We know, for example, that Farmers Home has not been very aggressive in trying to foreclose.

Senator BOSCHWITZ. What do you mean has not been that aggressive?

Mr. CROWLEY. Not been aggressive in foreclosing. And it is on the basis of how we see things like the 1982 servicing policy that Farmers Home used to help economically distressed borrowers.

New loans were given to them on the basis of whether they could merely repay the new loan, not whether they could repay old loans.

So, there has been an effort on the part of the Department.

Senator BOSCHWITZ. Well, we have given very extensive authority to the FmHA to expand and extend loans, and so forth.

Mr. CROWLEY. That is right.

Senator BOSCHWITZ. What you are saying is that they have indeed utilized those authorities?

Mr. CROWLEY. They have utilized it; yes, sir.

Senator BOSCHWITZ. 37,000 borrowers have not made a loan payment in over 3 years. How many of those are still in farming?

Mr. YEAGER. All of them.

Senator BOSCHWITZ. All of them are still in farming. And a guy who has not made a loan payment, he may have gotten additional loans even?

Mr. CROWLEY. Oh, yes; he has.

Senator BOSCHWITZ. Of those 37,000, do you have any sense of how many got additional loans during that period? No?

Mr. WELLS. No.

Senator BOSCHWITZ. But nevertheless, that is a terrible record, 37,000 not having paid, no payment. It says "no loan payment." That means neither a payment of interest or principal?

Mr. WELLS. That is correct. Senator, I do have those numbers for you, in terms of we did age the delinquencies. Of the 97,000 borrowers that were delinquent, 37,000 had not made a payment in over 3 years, 12,000 in 2 to 3 years, 15,000 in 1 to 2 years, and 32,900 borrowers missed a payment in 1 year or less.

Senator BOSCHWITZ. I see.

Mr. WELLS. We have 15,000 for 1 to 2 years.

Senator BOSCHWITZ. And you have the figures, too.

Mr. WELLS. Yes, sir; we have the figures on the age of delinquents in terms of the number of borrowers, as well as the dollars on page 79 of the report.

Senator BOSCHWITZ. Over 3 years is $4.8 billion. That is bad. Let me ask you one other question before my time expires.

You also pointed out the several programs, the five major programs, and noted that the great majority of the debt that is not being serviced properly is in the emergency disaster loan.

I wonder if you would describe or let me know your conclusions as to why that particular program seems to encounter more loan delinquencies than the others.

Mr. CROWLEY. We did not look into the specific reasons as to why that was. As I told the chairman previously, that loan program has a very large ceiling. You can get loans up to a half a million dollars in that program.

The loans are also at a relatively low-interest rate, 5 percent and 8 percent, and without doing an analysis as to exactly why, it seems to us that if people are financially stressed they will pay off loans that are at a higher interest rate rather than those that are at a lower interest rate.

Senator BOSCHWITZ. But yet those loans are not made, necessarily, to people who are financially stressed, which is why I asked the question. Those loans are made as the largest single element of the FmHA program, those loans are made on the basis of disasters rather than on the basis of financial need, or stress. Yet, they are the ones that are the largest—is that an indication that farmers may not be taking the FmHA seriously, or what?

Mr. **Wells**. Yes, sir; there is that possibility. I would also like to add that the eligibility requirements for the disaster program are different from some of the other farmer programs.

Senator **Boschwitz**. Yes.

Mr. **Wells**. Eligibility beyond a family farmer type definition. I might add that on several occasions, Mr. Clark, the Administrator of Farmers Home has testified that he, too, in looking at that program, has some concerns about the people that are in that particular program. So your question is very appropriate, and you might ask Mr. Clark to respond to that.

Senator **Boschwitz**. Is there any analysis of that in here? Such as why that portion of the loan portfolio does so poorly, when those loans are made without really reference to the economic stress for the particular lender?

Mr. **Crowley**. Senator, we did not look into that. That was not part of what we were supposed to do in this job, but that is a very valid question to be asked, and I think you probably should ask that of Farmers Home.

Senator **Boschwitz**. Yes; I will do that.

The **Chairman**. Rudy, the bell rang, ever so gently.

Senator **Boschwitz**. Did it? Yes. Thank you. Thank you, Mr. Chairman.

The **Chairman**. Am I correct, $800 million in the first 6 months of 1985?

Mr. **Crowley**. $763 million, I believe.

The **Chairman**. To farmers——

Mr. **Crowley**. Technically insolvent.

The **Chairman**. Who were technically insolvent?

Mr. **Crowley**. Yes. $763 million.

The **Chairman**. $763 million?

Mr. **Crowley**. Yes.

The **Chairman**. Now I want to recognize the lady who is the distinguished chairman of the subcommittee that has jurisdiction on rural credit, the able Senator from Florida. She has been vigorous, and I am anxiously awaiting her questions of you, but also, when she asks questions of Frank Naylor, et al. Senator Hawkins.

Senator **Hawkins**. Thank you, Mr. Chairman.

The **Chairman**. Thank you for all the work you have done. You have been great.

Senator **Hawkins**. Thank you. I apologize for being late. We have another committee meeting, as usual. I do have a statement, Mr. Chairman, that I would like to have submitted for the record.[3]

The **Chairman**. Without objection.

Senator **Hawkins**. Thank you. On the testimony that you delivered last night, Mr. Crowley, in terms of figure I.1: Index of Farm Debt, December 31, 1975 through 1984——

Mr. **Crowley**. Yes.

Senator **Hawkins**. From December 31, 1978, through December 31, 1980, this chart indicates that FmHA farm debt almost doubled.

Mr. **Crowley**. Yes.

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[3] See p. 55 for the prepared statement of Senator Hawkins.

Senator HAWKINS. During that 3-year period, FmHA farm debt climbed from $9.9 billion to $19.5 billion.

Mr. CROWLEY. Yes, ma'am.

Senator HAWKINS. And in comparison, all other non-FmHA farm debt grew from $131.2 billion to $162.9 billion over the same 3-year period.

Mr. CROWLEY. That is true.

Senator HAWKINS. Expressed in other terms, it seems to me that non-Government-financed farm debt grew by 24 percent over that 3-year period, while Government-financed farm debt grew by 96 percent. Correct?

Mr. CROWLEY. That is roughly correct; yes.

Senator HAWKINS. So, would you agree with my assessment, that Government was pursuing credit policies out of line with those pursued by private lenders during that period?

Mr. CROWLEY. Well, I think Farmers Home does pursue a credit policy that is out of line with private lenders. It is part of its charter, to be the lender of last resort.

Senator HAWKINS. But if you look at the total chart from 1975 to 1984, those were the years it ran amuck.

Mr. CROWLEY. Well, it looks pretty bad from 1980 on to 1985, too.

Senator HAWKINS. From 1981 to 1985, it was a slow buildup, but I am told, where Farmers Home was out asking farmers to refinance their farms, ran from 1978 to 1980. Farmers were busy, out tending their farms, and a handy-dandy FmHA guy came to see them, and said: "Hey, land value is up so high, you are really under mortgage; let's get your mortgage up there where it's attractive."

Mr. CROWLEY. Senator, I do not know anything about that specifically

Senator HAWKINS. That is what I am told.

Mr. CROWLEY [continuing]. To Farmers Home, but I have heard that of lenders, generally, during that time.

Senator HAWKINS. Well, I am told that it was—and these figures show that for those particular years FmHA grew about 96 percent, while other nonfarm, non-Government-financed loans grew by 24 percent. That is the largest out of synch growth in FmHA debt we have had.

Did your examination include FmHA servicing procedures?

Mr. CROWLEY. We did not look specifically at the servicing procedures. What we tried to do was to describe the shape of the portfolio, to try to give a capsule view of the individual borrower, and to give an overview of how Farmers Home's debts, delinquencies, and loan losses were mounting over a period of time.

We did not do an in-depth analysis of the causes of those problems, nor did we look at Farmers Home's procedures in that regard.

Senator HAWKINS. Are you willing to undertake such a task?

Mr. WELLS. We would be glad to discuss this issue with members of your staff. I would also like to add one point. The analysis that GAO did was to look at the actual results that had been achieved under the 1985 lending practices that were in existence at that point, and our general observation from the auditors that were in the field supports the statement, that we believe, in many instances, Farmers Home has walked that extra mile with a lot of borrowers, in a very liberal-type lending, servicing-type action.

Senator HAWKINS. I am told in my State, for instance, Florida, that our FmHA Director, he has a lot of loans that have not had a single penny paid in over 6 years.

Mr. CROWLEY. We show 3 years and over, and we show something like $4.8 billion, that there has not been a payment made in over 3 years.

Senator HAWKINS. Could you tell me how many of the loans are over 5 years? It is not on your chart, but could you provide that for the record?

Mr. CROWLEY. We could make a run for you; yes.

Senator HAWKINS. I would appreciate that.

The CHAIRMAN. What was your answer to that?

Mr. CROWLEY. I can make a run for her. We can run it through the computers.

Senator BOSCHWITZ. Will you do that for 5 and 6 years? Why do you not just do it——

Senator HAWKINS. How far do you want it, Rudy?

Senator BOSCHWITZ. I think up to 8 years.

Senator HAWKINS. Up to 8? That would be fine with me. That is fine. As long as you are doing it, you might as well run the whole tape.

[The information referred to above follows:]

NUMBER OF MAJOR FARMER PROGRAM DELINQUENT BORROWERS BY AGE AND DELINQUENT AMOUNTS—JUNE 30, 1985

[Age of delinquencies]

	1 year or less	1–2 years	2–3 years	3–4 years	Over 4 years [1]	Total
Number of delinquent borrowers	32,833	15,429	12,212	13,678	23,275	97,427
Delinquent dollars (millions)	$419.2	$484.9	$667.6	$1,334.4	$3,487.8	$6,393.9

[1] The FmHA data base available to GAO did not allow a more detailed breakdown beyond the 4 year category.

Senator HAWKINS. My time has expired but I will be waiting for——

The CHAIRMAN. Go ahead, Senator. We consumed some of your time by interrupting you.

Senator HAWKINS. Does your report include any recommendations on how to deal with the most heavily leveraged farmers and borrowers?

Mr. CROWLEY. The reports do not contain any recommendations. They are basically descriptive of a problem. What we have been talking about here today is that it is a problem, and we feel it is a problem that needs to be addressed and worked on. But as to specific recommendations, neither report made those.

Senator HAWKINS. Thank you. Thank you, Mr. Chairman.

The **Chairman**. Senator McConnell.

Senator **McConnell**. Thank you, Mr. Chairman. I, too, have a statement that I would like included in the record.[4]

The **Chairman**. Without objection, Senator.

Senator **McConnell**. You indicated, in answer to an earlier question from Senator Zorinsky, that perhaps we should concentrate on the farmers who have a chance of making it. I am wondering, though, with the high volume of total Farmers Home loans compared to overall agricultural lending, what would your analysis lead you to believe would happen if up to 30 percent of the Farmers Home borrowers simply went out of business? What would happen to agriculture if that happened?

Mr. **Crowley**. I do not know, Senator. We did not do that analysis. I really do not know what the downstream of that would be.

Senator **McConnell**. You are not prepared to take a stab at it? I am talking about 30 percent of——

Mr. **Crowley**. Thirty percent of borrowers——

Senator **McConnell** [continuing]. The Farmers Home borrowers simply being forced out.

The **Chairman**. I am having a little bit of difficulty hearing and you are right beside me. Now, did you make the point that Farmers Home lends to only 12 percent of the farmers? Is that not correct?

Mr. **Crowley**. Farmers Home does lend to only 12 percent of the farmers; that is right.

The **Chairman**. So you are talking about—

Senator **McConnell**. Thirty percent of the twelve percent that we are talking about.

The **Chairman**. Thirty percent of the twelve percent.

Mr. **Crowley**. I really cannot give you an answer on that. It would depend on the individual borrower as to how much was involved, how much land was involved, and how concentrated borrowers are. Are all the bad borrowers in one county?

If 30 percent of the bad ones went out, we would have a problem.

Senator **McConnell**. So maybe we ought not to just concentrate on those who are——

Mr. **Crowley**. Well, I think, Senator, that what I have described is a problem with delinquencies, a large number of delinquencies, and we have a program that is set up as a Loan Program, where the Government is supposed to at least ensure that there is some repayment of those loans. What I am suggesting is that Farmers Home needs to address that problem, needs to work with borrowers.

We are speculating a lot on how many farms are going to come into inventory and how many people are going to be put out of business.

I think what we need to do is to work with farmers to see if they can make it. I think that is where the emphasis should be.

Senator **McConnell**. This may be rehashing ground you covered a minute ago with Senator Boschwitz, but I would like to go back for a minute to the comparison of the Farmers Home Emergency

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[4] See p. 56 for the prepared statement of Senator McConnell.

Loan Program with the regular Farm Ownership Loans, and the Farm Operating Loans.

Explain to me the difference, again. The emergency loan is the one that has the greatest delinquency rate, is that it?

Mr. CROWLEY. That is correct.

Senator McCONNELL. And you indicated, did you not, that it was the lower interest, more easily acquired——

Mr. CROWLEY. Yes; it has a lower interest rate. The rates range from 5 to 8 percent. It has a higher ceiling than the other loan categories do. It has a half million dollar ceiling.

Senator McCONNELL. And what percentage of the overall delinquency pool is attributable to that?

Mr. CROWLEY. I think that was on that schedule that I——

Senator BOSCHWITZ. $4 billion of the $6.4 billion you said.

Senator McCONNELL. $4 billion of the $6 billion, Senator Boschwitz?

Mr. CROWLEY. Yes.

Senator McCONNELL. Well, go ahead again and give me a comparison of the two in terms of the interest rates.

Mr. CROWLEY. The eligibility requirements for the programs are—for the Emergency Disaster Programs are different also. You do not have to be a family farmer. Also, I do not think that you have to show that you have been turned down by every other lender in your community, before you can get a loan. So there are differences, that way.

Perhaps you did not get the schedule that I gave out before, but that program amounts to about a third of the total loans outstanding by Farmers Home, $9.9 billion out of $28 billion. In delinquencies, it accounts for $3.9 billion of the $6.4 billion.

The principal owed by delinquent borrowers, about half of that is in the Emergency Disaster Program, $6.7 billion.

Payments owed by borrowers who have not made a payment in 3 years, or more, is $3 billion in Emergency Disaster, as opposed to $4.9 billion for other borrowers.

Mr. WELLS. Senator, I would like to give you some of the percentages on the delinquencies. In the Emergency Disaster Program that we were talking about, with the over 3-year delinquent borrowers, that represents about 82 percent of the entire delinquency in that program, which contrasts delinquency rates in the other Farm Ownership, Farm Operating Programs, in the neighborhood of 56 percent.

So it is quite a substantial percentage increase.

Senator McCONNELL. Shifting to the borrowers who are current, are there any characteristics of those borrowers who are keeping up, that are noteworthy, that you might want to share with us?

Mr. CROWLEY. No, sir; we did not analyze specific characteristics of borrowers who are current.

Senator McCONNELL. One final question, Mr. Chairman. Do you foresee a growing trend of the noncurrent borrowers being able to catch up, or is it getting worse?

Mr. CROWLEY. The situation has been getting worse. Now, if you are asking for something in the last few months, I do not have the information on that.

Senator McCONNELL. Thank you.

The **Chairman**. Well, thank you very much, gentlemen. I imagine a lot of people are going to be studying these two documents, and I am a little bit surprised at myself for not asking for it earlier.

Mr. **Crowley**. It was not available earlier.

The **Chairman**. Well, that comforts me. If I had asked you, you would not have provided it, would you, because you did not have it? Well, in any case, we are grateful to you for coming. Your testimony was fine.

Now we have the second panel consisting of Frank Naylor, Under Secretary for Small Community and Rural Development of the USDA, and Vance Clark, who is Administrator of the Farmers Home Administration, USDA.

Senator **Boschwitz**. Before the gentlemen from GAO leave, I wondered, did you work with USDA, and what kind of cooperation did you find? Do you want to just characterize that?

Mr. **Crowley**. USDA provided us with the tapes that we used to make the analysis. The cooperation was excellent.

The **Chairman**. Let me say, Frank, and Vance, I know you are tremendously busy, and we are as well, so it underscores my appreciation for your coming up here.

Now we asked that you prepare testimony on your recently revised service regulations, and we will anticipate your comments on that.

And also, we would appreciate your comments on the GAO report, on the Farmers Home portfolio, and the testimony you just heard.

Specifically, I, for one, would be interested in your thoughts on the validity of the GAO data and its conclusions. If you have a prepared statement, you may proceed, and we will perk along.

STATEMENT OF HON. FRANK W. NAYLOR, UNDER SECRETARY FOR SMALL COMMUNITY AND RURAL DEVELOPMENT, U.S. DEPARTMENT OF AGRICULTURE

Mr. **Naylor**. Thank you, Mr. Chairman. I do not have a prepared statement, in a formal way, but I would appreciate the opportunity to share a few comments on your questions with you.

I would start by giving my commendation to you for the wisdom you have shown and the time you have taken to ask for this report. I thank you, as the chairman of the committee, for taking your valuable time, and this committee's, to bring up some of these very important questions in an appropriate setting, and for giving us an opportunity to address some of them.

The **Chairman**. I thank you, but I was constantly prodded by the chairman of the subcommittee, so——

Mr. **Naylor**. Well, I appreciate both of your efforts in that context. If I might, Mr. Chairman, just make a few opening observations, and address, in that fashion, some of the questions which were raised.

First of all, I would have to say to you that I think the General Accounting Office has done a very commendable and very professional job in the preparation of these two reports that they have provided to you.

They give, for the first time, I think, in a very concise way, an opportunity for the layman to have a better understanding of the complex problems which the Farmers Home Administration has been facing these last 4 to 5 years.

There are a number of questions that I think have been raised, with particular emphasis, looking at our portfolio, and recognizing that the most troubled area is the emergency disaster area.

Several of the Members have asked why that particular portfolio seems to be in so much trouble.

I would offer several observations. First of all, in the mid to late 1970's, the Congress passed a number of revisions and created a second category of emergency loans known as economic emergency loans. They reduced substantially the standards for qualification for those loans, and relaxed the restrictions on the amount of loan which could be made.

And indeed, during the 1978-79 period, there was no limitation whatsoever on either the amount of the loan or who could obtain them.

By that very nature, substantial amounts of loans were made which are now 3 or more years delinquent in that particular category of loan, which at the outset had the potential for failure.

Furthermore, within that category of loans, although Congress very quickly corrected the problem those changes caused a couple of years later, we need to understand that the very nature of the disaster loans is much different than our other types of lending activity.

In our basic Real Estate and Farm Operating Loan Program, we are making loans to produce a product which we expect to earn income and provide repayment ability.

In the case of disaster loans, however, we are attempting to replace lost income with lent money that has to be repaid, and for which there is no expectation of income, in effect, to really provide that repayment capability.

And so the Disaster Program, in and of itself, has a built in high risk of not being able to effectively repay those loans.

It is one of the reasons that the administration has so strongly recommended, with your support, and other members of this committee—an effort to move in that direction, to use an insurance program in lieu of this type of replacement of lost income. We need to treat this situation for what it is, a casualty loss, and something that cannot be corrected through borrowing more money, where repayment ability does not exist.

The combination of these two factors, the broadened eligibility and unlimited amount of funds that were lent in the late 1970's, combined with the very fundamental flaw in the disaster-lending approach to begin with, has led to a situation in which we have severe delinquencies in this program area. A number of these loans will very likely never be repaid, as they developed in the late 1970's, and through 1981, before we really were able to curtail the abuse of that particular Disaster Program.

And if you will note, in the last several years, the dollars outstanding in that program have begun to decline. With the assistance of Congress, we have been able to rein in and take, I hope, a more responsible approach. You further aided us, in the latest farm bill, to accomplish that objective.

During the time that I have been in office, Mr. Chairman, we have seen each year, I think at about this time, a good deal of comment by various officials and organizations around the country about the purported intentions of the administration to take very strong and very aggressive action against individual operators under stress. A great deal of concern is raised that we have intentions of foreclosing on large numbers of operators, and abandoning the intent of Congress, which you so accurately identified, with regard to the responsibility of the Farmers Home Administration. Each year, in May or June, the press comes to us and says, "What happened?" because those predictions did not come true.

I think if nothing more, your report, obtained from the General Accounting Office, gives the answer to that question. Throughout this administration, our objective has been, at every step of the way, to do everything we could to give our borrowers, as difficult as their situation has been, the opportunity to recover and become viable farming operations again.

If anything, perhaps particularly in our "policy loans," or "continuation loans," we have gone an extra mile, perhaps even beyond what some of the Members of Congress might have expected us to do in that effort, to maintain the opportunity for some recovery on the part of individual producers.

That has been particularly evident this year. Answering your last question, Mr. Chairman, with regard to our new policy guidance, about 2 years ago, an extensive number of law suits were filed, and there has been a great deal of misunderstanding as to what the law suits were really about.

Up until that time, the Farmers Home Administration did not have a written procedure, or regulation, which spelled out exactly what each borrower could expect in the way of support and assistance in attempting to deal with his loan if it became a problem.

The court suit simply said that unless we had such a uniform procedure, we could take no further action to deal with problem loans directly.

Last fall, we filed with the court a very extensive and comprehensive guideline as to what each borrower could expect, and what he should be able to obtain in the way of assistance from our offices.

These guidelines are very consistent with what had been our operating practice throughout this administration, put in regulatory form.

One of the requirements of the court was that any borrower who became delinquent had to be advised, no matter how small the delinquency, of what every one of his options were for assistance he could receive from the Government to deal with that delinquency, and if that failed, then advised of what would happen to him. And then one step further: What would happen if that did not resolve the problem?

In that process you have a procedure, Mr. Chairman, in which there are seven specific alternative actions, other than the borrower repaying, or making up his delinquency.

There are seven specific options that we can provide that borrower to bring his loan current, through deferrals, reamortizations, or reschedulings.

We are obligated to take each borrower, no matter how severe his problem, and to step through each of those options with that borrower, to determine if there is any conceivable way we can assist him.

If, after that is done, the borrower, and we, determine that none of those steps are helpful, the borrower has the option to disagree with us and to appeal that decision, and we will stand down and do nothing to the borrower while the appeal process is going forward.

Then and only then, after every other alternative has been exhausted, are we obliged to take action, as we responsibly should do, that would lead to foreclosure.

Many of our critics, in the last 60 to 90 days, have lifted out of context the last step, and characterized it as a massive effort of this administration to ignore, and not care, or be concerned or compassionate toward farmers.

During this time the American farmer, Mr. Chairman, is under severe stress in many parts of the country anyway. It has been an emotional and difficult period for them. These irresponsible statements by various individuals and organizations around the country, in my view, have been a major disservice to the American farmer, agriculture, the Congress, and the administration, who have worked so hard for us to have the means to serve and work with our farmers through this difficult period.

We are indeed about to send out servicing notices to two very distinct situations. For those borrowers who have not made any payment whatsoever in the last 3 years, either of principal or interest, or who are suspected, or known to have defrauded the Government, we are sending out a very strong servicing letter saying to those individuals, "You must be in contact with us within 30 days, and we must find a way to resolve your problem."

There are approximately 35,000 borrowers in that category who will receive that notification. Despite that strong notification, we will go through each of those servicing options with those individuals, and they will still have these very generous appeal rights before any actions might lead, ultimately, to a foreclosure situation.

The balance of our borrowers who are delinquent in any way this year, even as low as $100, will receive a notice from us, asking them to contact us within the next 30 days, so that we can take the various servicing options that are available to them, and see if we cannot resolve their delinquency. If they need financing for the next year, we will be able to provide for it and plan for it on an orderly basis, and work with them.

That is the fundamental basis of our servicing action that was put into place around Christmas of last year, and we are moving forward at this time.

Mr. Chairman, it represents a very compassionate, and by any standard of commercial lending, a very generous approach to dealing with a very difficult situation, while still attempting to adequately protect the interest of the taxpayer and the substantial investment they have made.

We do walk a very narrow line. It has been a difficult line. We hope that we are doing it successfully. We believe the record shows that we have. Indeed, the record last year of more than 45,000 actions, to bring loans delinquent under these very guidelines we are talking about, indicate the extent to which the agency has gone to assist operators under stress. The record of our being able to stay with 97 to 98 percent of our borrowers and working through difficult times also indicates our willingness to do so.

But I think in closing, Mr. Chairman, we also have to recognize that particularly in some of the loans developed in the late 1970's, where debt-to-asset ratios are not 1 to 1 but 2, 3, and 4 to 1, the realistic opportunity of resolving those is just not there. We have an obligation, in fairness not only to the taxpayer, but to the borrower, to resolve these issues. We should resolve them in a timely way, in a way that is equitable to the borrower, and is responsive to his problem, and as best we can, also protects the interest of our taxpayers.

I think we are obliged to do that. If we did less, you would find serious fault in us.

The CHAIRMAN. Thank you very much. Before we call on Mr. Clark, you say there are 270,000 Farmers Home borrowers, is that not correct?

Mr. NAYLOR. About 270,000, Mr. Chairman.

The CHAIRMAN. Yes; and my recollection is that 37,000 will get these notices?

Mr. NAYLOR. There are about—yes, about 35,000 to 37,000 that have not made any payment on one or more loans for 3 or more years, or are involved in a possible defrauding situation.

The CHAIRMAN. Now that does not mean that they are going to be foreclosed upon, all 37,000 of them?

Mr. NAYLOR. Absolutely not. Most of them will probably be able to resolve their problem in some form, using one of these seven servicing options we have discussed.

The CHAIRMAN. That is a little bit different from all of the publicity that we read some weeks back, "Henny Penny, the skies are falling," and of course they are falling for individuals. But I am surprised at the amount of mail that I am getting from farmers who are talking about this thing.

They have complimented the Congress for tightening up on these programs, and I just wondered if you had a feeling that the whole loan program just sort of "grew like topsy," for a period of years, and all of a sudden we find out that we have a problem.

Well, let me see, that is a rollcall vote. I guess we should recess and go over and vote, and come right back, if that will be all right. Otherwise, there will be confusion. If you will await our return.

Mr. NAYLOR. We will.

The CHAIRMAN. OK. We stand in recess.

[A vote recess was taken.]

The CHAIRMAN. The committee will come to order. Mr. Clark, we will be pleased to hear from you, sir, and if you will use that microphone and move it in a little closer to you.

STATEMENT OF HON. VANCE CLARK, ADMINISTRATOR, FARMERS HOME ADMINISTRATION, U.S. DEPARTMENT OF AGRICULTURE

Mr. **Clark**. Thank you, Mr. Chairman, and members of the committee who are not here yet. I appreciate this invitation to be before you also. I do have a prepared statement that I would submit; I think it has been submitted.[5]

The Under Secretary has stolen all of my thunder, so I really will not dwell on all these items again.

I would like to make a point, however, to augment what the Under Secretary said, that we, too, appreciate the GAO report.

I think it gives us ammunition to better discuss the issues that are before our agency, particularly, and some of the items of concern of this committee, and others.

I think we can better respond if you have that data to allow you to make those determinations. I also would make the point that we are getting a lot of publicity, obviously, in our servicing actions, and I would say there seems to be some pluses in that, maybe some minuses, but the pluses seem to be that many of our borrowers now are more aware of what we are attempting to do, are more concerned perhaps about our determination in those directions of collection. I must say, our cash-flow has picked up considerably in the last couple of months. So that is a big plus.

So, maybe that has been to our benefit and to the taxpayers as well.

The **Chairman**. Could I ask a parenthetical, where you stand with respect to publishing your regulations to implement the credit provisions in the farm bill?

Mr. **Clark**. Well, we are running into a few glitches, as always. General Counsel has been working diligently with us. We are still working very hard to do that. We are aiming for very soon, in the next couple of weeks to do that. I would hedge my bets for the moment—but it is probably going to be the next 3 weeks before we really get on that. We are working very hard to do that.

Also, we are considering that perhaps we do not have to publish all those regs in one giant publication. Maybe we will poll out and segment items that could be used immediately in our servicing actions, in having some relief evidence to our borrowers. So we are considering that as well.

The **Chairman**. Forgive me for interrupting, but that was on my mind.

Mr. **Clark**. Again, the court restrictions against us in the past 2 years have, indeed, dampened our collection efforts. I guess if those had not been imposed upon us, we would not be facing a lot of the items we are facing today. I think the misery, if you will, would have been spread over a 2- or 3-year period. It would have made more sense to do it that way.

But now that they are released, we can go forward, and I think we are going to do it very logically, in a very business-like manner, and certainly, we are not going to act capriciously as we start adverse actions that need to be done.

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[5] See p. 57 for the prepared statement of Mr. Clark.

With that, I would be happy to share with Mr. Naylor any questions that you or the committee might have.

The CHAIRMAN. Very well. I would like for you to explain for the record, the fact that between 41,000 or 42,000 new loans, totaling about $2.17 billion were made to technically insolvent farm borrowers in extreme financial difficulty during the first 6 months of 1985.

Mr. NAYLOR. Perhaps I might better answer that because Mr. Clark was not onboard for that period of time, Mr. Chairman.

The CHAIRMAN. Please do.

Mr. NAYLOR. Those loans, by and large, fell under this category that we called continuation or policy loans. They involved basically, I think, two decisions, Mr. Chairman.

First, it was our hope in many cases, as we looked at the operator, that an additional year of lending just enough for operating expenses, in effect setting aside these other loans, might give him the potential for beginning to turn the corner—at least the hope that that corner might be turned. It was worth the additional risk, the "extra mile," if you will, to accomplish that, by taking what amounted to an extremely high-risk loan for which the only collateral was the current year crop.

And we recognized that he was falling further behind on his other loans. Now some of those loans, indeed, were excessively risky but on balance, I think the administration attempted to go a long extra mile, in the expectation that with new farm legislation and some improvements in the economy, many of these individuals might have some opportunity to recover.

The second consideration, in addition to the restrictions of the court situation, was the recognition that if you were to move precipitously, particularly in some areas of the South—some of the Southern States, Mississippi, Georgia—not only would you have adverse impact on the individual borrower, but we could have a very dramatic impact on the entire community. If we moved in a very aggressive, very broad way on a large number of operators at one time, in the end, the overall impact on the economy would have been disastrous in that localized area.

It was a difficult choice, and it is one for which we have been criticized from both directions: On the one hand, that we were far too generous, and did not adequately take care of the taxpayers' interest. There is a good argument, in some cases, that that may well have been the case.

On the other side of the coin, we have been chided that we were not generous enough, that there were even additional people that we should have gone with that we did not. On average, over the last 4 years, we have had from 6,000 to 8,000 of our borrowers not able to continue operation, who have had to go out of farming because there just was no realistic way for them to continue to be financed.

The CHAIRMAN. Well, laying aside the question of compassion and trying to analyze what it would do to the community, as you just stated, what effect do you think it had on the—this was 1982 when that policy was embarked upon, right?

Mr. NAYLOR. 1982, 1983, 1984, yes.

The CHAIRMAN. Yes; the debt-to-asset ratio was what, 70 percent?

Mr. NAYLOR. Average 83, on our delinquent cases.

The CHAIRMAN. Have you given any thought to the impact on the FmHA portfolio without the policy loans of 1982, 1983, and 1984?

Mr. NAYLOR. In many cases those operators would have ceased to be in business because they would have been unable to get their crops into the ground at all. We would have had, probably, some substantial losses that we would have recorded at that time.

For others, it did indeed further erode their position, and it will continue to do so, as long as you have situations where they not only have this prepayment problem, but have a negative cash-flow situation as extensively as some have had over the last few years.

The CHAIRMAN. This past November, the agency indicated that 20 percent, or about 52,000 farm borrowers were technically insolvent, is that right?

Mr. NAYLOR. That is correct.

The CHAIRMAN. And another 33 percent, or about 86,000 were categorized in, "extreme financial difficulty."

Mr. NAYLOR. Yes. That is the 70 to 100 percent.

The CHAIRMAN. Now how are you going to deal with the folks in these two categories in 1986?

Mr. NAYLOR. Mr. Chairman, in most cases they are delinquent; they are one and the same. We will sit down with them and take each of our servicing options and determine if we can restructure their loans and their operations in a fashion that will permit them to have a realistic opportunity to succeed, to repay their loans, and to return to profitable operations.

Only after exhausting every one of those options, will we then look to some form of helping them step out of the farming situation.

In most cases, I think we will be able to use some combination of servicing options, and be able to work with that borrower. But there unquestionably will be some cases, perhaps a number of cases, where that simply will not be possible.

The CHAIRMAN. Senator Andrews and I were talking earlier this morning in the back office about farmers—and I hope it is a small percentage—but those farmers who like, anywhere else in the economy, abuse the system—that is to say, for example, are there any measurable number of, or percentage of farmers who have assets and personal holdings to make payments on their loans, but because of the situation, just simply have not done so? Have you run across that?

Mr. NAYLOR. There are some situations, going back to the Economic Emergency Program in the late 1970's, where that indeed is the case, Mr. Chairman. There are, fortunately, a very small number of situations where the borrower is able to shelter other assets from the Farmers Home Administration, and effectively block us from being able to obtain repayment, when they probably have the capacity to do so.

The number of cases in that category is quite small. There are a few additional cases which we are concerned about, where some sort of improper action, defrauding of the Government appears to have occurred, and we will aggressively pursue those cases. Our current estimate is that that number is relatively small, perhaps in the 3,000 range out of a total community, and most often involves the improper sale of collateral that was given to support the loan.

The **CHAIRMAN**. Now the GAO report indicates there are a little more than 30,000 borrowers who are classified either as technically insolvent or in extreme financial difficulty, having loans of about $5 billion, a little more than that.

Now, if these borrowers are liquidated, what would be the cost to the Government, or the taxpayer?

Mr. **NAYLOR**. Well, that is an uncertain question at this point, Mr. Chairman. It would be substantial. The ultimate cost to the Government and the taxpayer would be the difference between the amount raised from liquidation of assets and what they owed us.

We have some cases in the South, particularly in this economic emergency category again, where loans—and if you will recall, Mr. Chairman, Congress did not put a repayment ability provision in that particular loan category. They did not have to show repayment.

And so we ended up with cases where the loans were two or three, or four times more than the collateral to support the loan could provide.

In those cases we will take some very heavy losses. This is purely my personal speculative figure. Maybe 50 cents on the dollar of the most severe cases, is all we could expect to recover, if that.

The **CHAIRMAN**. Fifty cents on the dollar. Well, I know you are going to have a--somebody used the word "onslaught of borrowers"—this planting season. Do you have enough manpower to handle it?

Mr. **NAYLOR**. Mr. Chairman, as you know—and this is a common discussion before Congress—most farmers wait until the end of January and then they all arrive on our doorstep at the same time, and they all need to have an answer before they plant in the spring.

We do not have the adequate permanent personnel to deal with that problem. We hire, or cooperatively obtain volunteers, as we are going to do this year, to help us handle that very heavy peakload.

I feel compelled, Mr. Chairman, to share this with you, as an important observation. The new farm bill requires us to have adequate staff and to use the revolving fund to accomplish that, and we will meet that requirement.

But it is also our understanding in the case of Gramm-Rudman, that we will have to make a direct offset of some sort later in the year, within the agency, for any use of that revolving fund as provided for under the farm bill. So we will have to deal with it in some other way in the agency before the end of the year under the Gramm-Rudman provisions.

The **CHAIRMAN**. Do you think you have enough loan funds?

Mr. **NAYLOR**. At this point it is a little early to tell but it is going to be very close. The demand is going to be—and already on our Guaranteed Program, is running well ahead of last year, but we have a significant amount of funds, more in that area than we had last year, and so I am optimistic at this point.

But it is going to be a difficult year. I think the advanced deficiency payments will help take some of the pressure off because many farmers will attempt to use that instead of loan funds.

I think it may surprise us in reducing some of the pressure we might otherwise have.

The CHAIRMAN. All right. Now this came up several times during the consideration of the farm bill, during the markup, and on the Senate floor. Farmers Home was designed to help whom, the family-size farm, right?

Mr. NAYLOR. That is correct.

The CHAIRMAN. Now the Economic Research Service defines a commercial family-size farm as one having a farm income between $50,000 and $500,000.

Mr. NAYLOR. That is correct.

The CHAIRMAN. Now the report indicates that 1 percent of the farm borrowers had sales of over $500,000, thus resulting in loan assistance to larger than family-size farmers. Just for the record, do you want to explain that.

Mr. NAYLOR. Yes, Mr. Chairman. I think you will find, in every instance, those were loans made under the provisions of the Economic Emergency Act, and had not yet been repaid, and are still in the hands of operators when no such restrictions were applicable.

The CHAIRMAN. Very good. I am sure my time is up. Did you ring the bell on me?

Senator BOSCHWITZ. There are only two of us.

The CHAIRMAN. Well, there are three of us.

Senator BOSCHWITZ. Oh, pardon me; pardon me.

The CHAIRMAN. Senator Boschwitz.

Senator BOSCHWITZ. Let me pursue some of the questions that I asked of the GAO, and let me also ask, what the experience has been this year. You said that this year was a little better? Because I presume the GAO report really dealt with payments that were made last January, and therefore, have not dealt with payments that have just been made.

Do you have any material, or, how are you doing this year? Better than last year? Is that what you said?

Mr. NAYLOR. Again, I think all of the controversial publicity we are getting has helped, and I think the attitude is changing, and as I say, our cash-flow in to the agency has gone up in the last few weeks. So it is helping. Again, the numbers have dropped.

Our number of borrowers 3 years or more delinquent now is like 27,000, the last figures I had. So there will even be less letters going out.

So it has paid off.

Senator BOSCHWITZ. Not 37 but 27? Is that because some of them have been going out of business, I presume?

Mr. CLARK. Yes; that, too, but I think there has mysteriously developed, some cash out there, that we did not expect before.

Senator BOSCHWITZ. You know, these payments to the FmHA are annual payments; they are not monthly payments.

Mr. CLARK. Right.

Senator BOSCHWITZ. So they are big payments. Those are harder to collect, very frankly, and it would seem to me that banks, or other lending institutions could simply outmaneuver you. If I were a bank and I knew you had one big payment a year, I think I would start stringing them out a little bit more and making them monthly, if I could, and of course, farm income does not always come in that way. But a lot of farm income does come in as a consistent cash-flow. Why is there a once annual type of payment?

Mr. CLARK. Well it is a good question. However, Senator, you are right: Most crop income is due as that crop is harvested, but there is no reason we cannot practice the same payback philosophy and management practices that are in the private sector. Indeed, if the corn comes off at one time, we ought to have that income; if soybeans come in another time, we ought to have that income.

Senator BOSCHWITZ. Most of your loans, you are suggesting, are to crop farmers, not to farmers who have animals, who have a more steady sort of income?

Mr. CLARK. No, the same way If those animals are being marketed regularly, we should be able to collect regularly.

Senator BOSCHWITZ. They are being marketed regularly.

Mr. CLARK. I would agree with you, and I think we can do some of that. We are now discussing some of these proposals with our State directors for 1986, so we might indeed be plugging in some of those concepts.

Senator BOSCHWITZ. You know, I am just a peddler. I was never in the banking business. But one of the ways of selling goods is that you look at how much they have to pay every month, and, well, if they can afford to pay this much they will buy a new car at 7.9 percent, 7.5 percent, and that is all part of that sales schtick. But to have a one annual payment, in my judgment, is a tough way to do business.

Mr. CLARK. I would agree. I think our funds disbursement should also be stretched out. There is no reason a farmer should have a fund disbursement the same way.

Senator BOSCHWITZ. Do you have authority, that you could do that?

Mr. CLARK. As far as I know, we do.

Mr. NAYLOR. Yes, Senator. We do have that authority. As Mr. Clark and I have discussed, increasingly, we are trying to make collections during the course of the year. In the dairy business, for example, we have worked out arrangements with our borrowers as they get their milk checks, to make the payment and keep the loan current during the course of the year. Your observation is well-founded.

Senator BOSCHWITZ. These 27,000. Senator McConnell asked a very interesting question, what would happen if 30 percent of the 12 percent—I think Senator Helms said 12 percent of the farmers are in Farmers Home—and 30 percent of them are in real tough shape.

Have you made any assessment of what would happen if they went under? You touched on that a little bit, but what would happen if you were to come down on them?

Mr. NAYLOR. Yes, Senator. Over the course of the last 4 years we have made that a very important part of our assessment, to have a sense of what the impact would be on an individual community as well as the individuals involved. We have factored that into our considerations and management policy decisions and used great care in that regard.

We have had, on average, over the last 4 years, from 6,000 to about 8,000 operators a year who have left farming for any variety of reasons, but most often economic stress. We simply have been unable to help, and they have been unable to find anyway to make their operations successful.

Senator BOSCHWITZ. You know, one of the interesting things about all these statistics is that, things I have noticed about the FmHA, that you are really directed at the Southeast, and that without meaning to indict anybody, I am really surprised to find that time and again in these statistics, the largest debtor is Georgia, and the second is Texas, and the third is Mississippi.

Among the top 10 large debtors, with over 3-year delinquencies it is even more interesting. Minnesota is the only State that would be considered a farm State, that is, among the top 10, and we are quite a way down the list, even from the standpoint of total dollars.

I noted that we have been talking about the emergency disaster loans. The top eight States—none of which are Middle Western States—account for $2.5 billion of the $3.9 billion of total delinquent dollars. This was basically a happening of the late 1970's, I believe. Could you comment on that? That is why, of course, Senator Cochran is so wound up, because you would be coming down on 500 million dollars' worth of loans, in Mississippi. Which interestingly, is out of a total nationally of less than $5 billion, so Mississippi has more than 10 percent of the Nation's total—and his State is only the third largest FmHA loan volume State. Certainly any crackdown on loans would have quite an impact over there. But what happened, and how can we get out of that as taxpayers?

Mr. NAYLOR. Senator; there are two answers to your question. First of all, during the late 1970's, the Southeastern Commercial Bank, and to some degree, even the Cooperative Farm Credit System, pulled out of a lot of their agricultural lending. It effectively was transferred over to the Farmers Home Administration. In several of those States, we became the principal lender if not the majority lender, the monopolistic lender of that region.

And a very heavy amount of that was in the so-called emergency loan area. Also, in 1977, 1978, 1979, and 1980, the records indicate that the agency appeared to place a very strong emphasis on several Southern States in their lending activities. If we were to supply you—although that data is sometimes not totally complete—a record, there were a number of very large loans made under several different programs in that area, which caused a substantial increase in concentration of debt in that particular region.

Senator BOSCHWITZ. What do you mean by very large loans?

Mr. NAYLOR. In excess of $1 million.

Senator BOSCHWITZ. I will return to the question. Senator Hawkins has now returned.

The CHAIRMAN. All right. Senator Hawkins; then Senator Boren.

Senator HAWKINS. There has been quite a stir, Mr. Naylor, over the so-called Coleman regulation?

Mr. NAYLOR. Yes, Senator.

Senator HAWKINS. And the notice of intent to take adverse action. It is my understanding that the Department has revised these notices and removed the banner headline, "Notice of intent to take adverse action."

Frankly, I was really surprised that this notice was not entitled: "Opportunity to reschedule FmHA debt."

I say this in light of the fact that you provided seven servicing options beginning with deferral. So I think the Department brought a lot of heat on itself from that approach.

Do you have any particular thoughts, now that you have been through the furnace and back, on how to improve the perception of your efforts?

Mr. NAYLOR. Yes, Senator; we do. We have revised the format of the notices substantially. Even in the original notice, Mr. Clark had his own covering letter which thoroughly explained why the particular information was being provided to the operator and pointed out our intention to be of service to them.

One of our problems, that concerned me greatly was the very early statements of various individuals and organizations which lifted out of context, one of the three major portions of that letter, which discussed the possibility, as a very last resort, that a foreclosure might ultimately occur. They chose to characterize those as "foreclosure notices." This caused an undue amount of emotional stress, I think, on many of our operators around the country. I have been very candid in my view that those individuals knew that that is not what those statements were, knew that they were servicing documents, knew that our policy was to extend every servicing assistance we could, including the seven options you mentioned, and despite that knowledge, made irresponsible statements that caused a great deal of stress around the country, and left us, I think, with no responsible option but to do exactly what you suggested. And that is, to significantly revise the format and make it undeniably clear what our intentions were.

Senator HAWKINS. In areas where FmHA provides a large percentage of the farm credit, in some cases almost all, what is FmHA doing to increase the involvement of private lending institutions?

Mr. NAYLOR. We are pursuing a very aggressive policy of trying to move to guaranteed loans in which the commercial lender, or the Farm Credit System lender would remain with their borrowers and would be the source of credit even on the most difficult cases.

It is our hope that we can ultimately move entirely in that direction as a much better way of servicing farmers, and keeping them with the lenders with whom they are used to dealing.

We are very appreciative of the help Congress and others have given us to move in that direction. The latest farm bill helps us get that underway. I think it will be to the benefit of the American farmer to quickly get that accomplished.

Senator HAWKINS. Did I understand you to say in answer to Senator Boschwitz, you have 7,000 dairy farms delinquent?

Mr. NAYLOR. No; I do not think I gave a number of dairy farms. What I had indicated to the Senator was that in trying to obtain repayment, we were trying to schedule more frequent payments than annual. In other words, they get a milk check and we arrange for them to try to move to keep their loans current.

Senator HAWKINS. That number may be in the GAO report I am told by staff, but do we not still have a surplus of milk?

When I left here in December we had quite a surplus of milk.

Mr. **Naylor**. Oh, yes. There were a number of new start dairy loans made in the late 1970's, when the subsidy payment was moved up within that administration. The Department, the agency, was encouraged on the basis of higher subsidy payments, to encourage operators to start new dairy operations with Farmers Home Administration loans.

They made the assumption, when they made that kind of loan, that the subsidy level was going to remain forever into the future, which of course was not the case. I think most agriculturists at the time would have pointed out that was not something you could sustain.

Senator **Hawkins**. Could you basically call that a transfer payment?

Mr. **Naylor**. Well, in those particular cases they were loans, in my view, which should never have been made. They created additional pressure on the industry and on the individuals already in the industry, and they were based on unsound assumptions in the first place. We ceased those loans as soon as we came into the administration in 1981 and have continued that practice since then.

Senator **Hawkins**. Farmers can improve their cash-flow and sustain their operation by augmenting farm income with nonfarm income. Have you done anything to encourage farm borrowers to augment their income with nonfarm income?

Mr. **Naylor**. We do encourage that although we have a bit of a catch-22. Mr. Clark is working on a revision of our family farm definition. They would in effect lose their eligibility if over half, or the major part of their income came from off-farm sources. Obviously——

Senator **Hawkins**. Can we not help you with that? I mean, is that not something we can help you with?

Mr. **Naylor**. Yes; and I think we can and are proceeding to deal with that, on our own, by regulation, and Mr. Clark is in the process of revising the guidelines.

Senator **Hawkins**. I sit on the Labor Committee also, where we are having great problems throughout the United States on job training, where certain talents have become obsolete, and rather than putting those people on welfare, or taking their home, et cetera, they just go to the private industry council in the local neighborhood and apply for job training for skills that are currently needed. Time magazine even notes that earnings average about $8 an hour for those graduates from Job Training Partnership Act programs. It might be possible to contract with these people, that once they get the job they will pay *x* amount from their nonfarm income.

It seems to me that we could sit down around a table and figure out what is available in the Government bag of goodies and still not rip off the taxpayer and help the farmer learn new skills.

Mr. **Naylor**. Senator, we are proceeding along those lines. Many of our borrowers do have off-farm income. I would be very happy to work with this committee and the Labor Committee on that issue. Some of the programs to which you refer do not reach out into the deep rural areas.

Senator HAWKINS. No, no; I guarantee you they are in rural areas.

Mr. NAYLOR. Well, by that, though, I mean the alternative employers are not close at hand, and would require the operator to actually leave the area. That is more prevalent in the Prairie States than it is in the South, where many of our operators do have alternative employment close by. And the suggestion you have is very useful and very applicable.

Senator HAWKINS. I know my time has expired, but in talking to farmers whose sons in the late 1970's graduated from high school and became farmers immediately because it was so enticing and alluring, because of the debt they could get at 18 and 19 years old, become a farmer at once, and now have no skills whatsoever except to drive the tractor that has been repossessed.

It seems to me that we could aim in together.

Mr. NAYLOR. Senator, we have had some preliminary discussions with the Labor Department on that, and there was some discussion during the course of the farm bill, whether an option of that nature would be considered. I suspect that we will continue to look at that with the committee, and others, as an alternative.

Senator HAWKINS. It is just a golden opportunity because farmers work hard. We do not have to teach them to work. We just have to give them a skill.

Mr. NAYLOR. I understand. Of course one of the provisions in the farm bill, Mr. Chairman, as you recall, is the homestead provision which also anticipates that same course of action. In it, we can work with an operator to provide them their home, even though they may go to off-farm employment as their principal source of income.

The CHAIRMAN. Senator Boren.

Senator BOREN. Thank you very much, Mr. Chairman, and I appreciate your calling these hearings so we could explore this subject.

Some of us had an opportunity to sit in and talk about some of the same issues over at the Appropriations Subcommittee when they met a few days ago.

Looking at the GAO report, I am very concerned by the figures, as I am sure you are, citing that the average Farmers Home borrower now has a debt-to-asset ratio of 83 percent. I know that is weighted because it includes some that are 200 and 300 percent; they are completely underwater.

But still, 51 percent have debt-to-asset ratios above 70 percent, which is very, very alarming.

Senator BOSCHWITZ. Fifty-one percent?

Senator BOREN. Fifty-one percent. Twenty percent are technically insolvent. They have over a 100-percent debt-to-asset ratio and 31 percent more have debt-to-asset ratios in the range of 70 to 99 percent. So it is a total of 51 percent——

Senator BOSCHWITZ. Of?

Senator BOREN [continuing]. Of the farm borrowers, have debt-to-asset ratios of 70 percent or above. My question is, if you were to have another 10 percent decline in land values, would this not have a very substantial effect in terms of forcing more farmers into that high-debt-to-asset ratio category, and have a very damaging effect on their ability to service, and a damaging effect on the security of your portfolio?

Mr. **Naylor**. Well, we typically, Senator, have a second position with regard to real estate, but the obvious answer to your question is, yes, a further decline in collateral value would impact on their debt-to-asset ratio, not necessarily their repayment ability, but certainly the strength of their supporting collateral.

One of the major things we look to in the farm bill is our belief that we have reached about the bottom of the curve on farmland in most of the Midwest, and that we indeed may look toward a strengthening market later in this year.

I do not think you will see any dramatic recovery in farmland values, but I think you will see them stabilize and gain a little bit of strength.

Senator **Boren**. I certainly hope you are right. We have not seen it in our area yet. They are still showing some decline. It does not appear to have quite hit bottom. But I hope you are right about that.

There are 37,000 borrowers, I gather, that are in the category now to whom you will send some notice. 37,000 who have not made a payment in the last 3 years, is that correct?

Mr. **Naylor**. Three years. The latest numbers look like it will wind up perhaps less than that, but in the vicinity of 30,000.

Senator **Boren**. How many, originally, were you going to send notices to?

Mr. **Naylor**. Well, that gets back to the original procedure. We originally had anticipated sending a general servicing notice to all delinquent borrowers which outline the seven servicing options, their appeal rights, and so forth.

Senator **Boren**. How many would that have been?

Mr. **Naylor**. Roughly 72,000, total.

Senator **Boren**. Let us say that you go through all the options and you find that for a certain portion of these 37,000, perhaps a third of them, you are not able to find some way under your current guidelines to work with them, so you go into foreclosure action.

If you foreclose on 10,000 borrowers and the holdings of those borrowers—let us just take that as a hypothetical. I am not suggesting you will, and I hope you will not.

But if you did, what would you do with the land and the equipment that would be foreclosed upon? What would be the policy? What are you doing with the land that you have foreclosed upon previously?

Mr. **Naylor**. If I may, Senator, let me put it in the context of foreclosure. The land that we have in inventory, where it is in areas that the land values have not stabilized, we are holding off the market.

We took the lead in that action among lenders a couple of years ago, and we are continuing that policy. We will hold property, where it would have an adverse impact on the economic situation and value of land.

Senator **Boren**. What percentage of the land on which you have foreclosed, or that you have in inventory, have you held off the market, and what percentage have you put back on the market, oh, say, over the last 3 years?

Mr. NAYLOR. I do not have those exact numbers for you except to tell you that in the Midwest, and in your area, where the most precipitous falls of property values have occurred, we have held the land off the market throughout that period.

Senator BOREN. It would be very helpful to me, Mr. Chairman, if perhaps, you might get that figure for me in terms of how much of the land is being held, in inventory, and not put back on the market, and what portion you have been able to put back on to the market.

I think that is something we must give very serious attention to during this particular time. If additional land is put in inventory, we want to make sure it is not put back on the market in ways that would further—not only will it hurt the farmers; it is going to hurt even the financial stability of your own agency, and your own portfolio, if that is done.

I am very concerned about what is going to happen to wheat farmers' income, and I am disappointed that the administration, last week, apparently announced that on the set-aside acres on wheat, we are going to have a $1.10 payment rate on the PIK rate instead of $2.

We have been told what probably would happen, when we were discussing the farm bill, that once the Gramm-Rudman cuts are applied, that we could have an 11-percent decrease in income of wheat farmers this year from previous levels.

Given the debt-to-asset ratios I have cited and the bleak income picture, do you see any way that we can stabilize the loans you are dealing with here? We have $6.4 billion of loans that are delinquent, almost half your portfolio, I believe, according to the GAO report.

Is there any way in the world we can stabilize this situation, unless we find some way to get the farm incomes up during the next 12 to 24 months?

Mr. NAYLOR. Senator, you and the other Members of Congress participated in passing a very broad-based and a very generous farm bill. With the target prices that have been provided for the operators who participate in those programs, there is a substantial income support base during the transition of the policy this bill anticipates. It provides all lenders, not just Farmers Home, the opportunity, and in fact I would say the responsibility, to undertake substantial work to help them restructure their operations, and their debt, in such a way that they can sustain themselves and be profitable.

Senator BOREN. If there is not an increase in farm income, as I say, I think the Department itself, even with all these factors you have mentioned, are estimating that the income may, in the next 12 months, be lower than the year before for wheat farmers.

If that occurs, are there other proposals that you would consider making to us, to deal with that situation, because obviously, your portfolio is going to deteriorate further if the income levels do not at least stabilize?

Mr. NAYLOR. No, Senator; I would not anticipate doing that because the Congress, over the years, has given us an enormously broad range of discretion to work with operators, and we have made full use of it, and continue to do so. We will have to work more closely, but we have the authority to do that, with the commercial lenders and the Farm Credit System, in coordinating and dealing with problem debt that they all hold, particularly in your area.

But I believe as a result of the farm credit legislation that was passed also last fall, the opportunity and capacity to do that exists.

Senator **Boren**. That pooling, have they already started that operation, of pooling between districts?

Mr. **Naylor**. No.

Senator **Boren**. Is that system beginning to get underway?

Mr. **Naylor**. It is beginning to move, to get it in place, but I think it will probably be another 30 to 60 days before the Capital Corporation, based on the last information I have, will begin to fully function, or be in a position to do so.

Senator **Boren**. Thank you, Mr. Chairman.

The **Chairman**. Well, I did not ask all of the questions that I had. I am going to submit them, in writing, and ask you, if you will, to respond in writing.

[The written questions from Senator Helms and Mr. Naylor's answers thereto follow:]

Question. How does FmHA plan to proceed with borrowers who are behind on payments on existing loans?

Answer. The following procedure will be followed in the issuance of notices to FP borrowers whose loans are in monetary default. These procedures do *not* apply to nonmonetary defaults. Borrowers who have made unauthorized dispositions of security will be handled under Section 1962.49(c)(1) and *no* cover letter will be used. Borrowers who no longer operate their farms will be handled under FmHA Instruction 1965-A and *no* cover letter will be used. Borrowers under the jurisdiction of a bankruptcy court will be handled under Section 1962.47.

CATEGORY 1

The following borrowers will immediately be sent: Forms FmHA 1924-14 "Farmer Program Borrower Servicing Options Including Deferrals and Borrower Responsibilities," 1924-25 "Notice of Intent to Take Adverse Action," 1924-26, "Borrower Acknowledgement of Notice of Intent to Take Adverse Action" and cover letter, Attachment A.

Borrowers who have at least one loan on which no payment has been made for the past three years (since December 31, 1982) as per Report Code 540 d "Status Report of Farmer Program Accounts."

When all servicing actions requested by the borrower have been considered and it has been determined that available servicing options cannot be granted, the borrower must be notified of FmHA's decision and given the opportunity to appeal. While any appeal is pending, a current FmHA Farm and Home Plan must be developed and Form FmHA 1962-1 "Agreement for the Use of Proceeds, Release of Chattel Property" must be completed providing for the sale of security property and release of proceeds for essential family living and farm expenses. Such releases must be provided during any administrative appeal proceedings and continue until such accounts are accelerated.

CATEGORY 2

Borrowers not in category 1 who are in monetary default as of December 31, 1985, (Finance Office Report Code 540) will immediately be sent Form FmHA 1924-14 only and cover letter, Attachment B.

When all servicing actions requested by the borrower have been considered and it has been determined that available servicing options cannot be granted, the borrower must be notified of FmHA's decision and given the opportunity to appeal. While any appeal is pending, a current Farm and Home Plan must be developed and Form FmHA 1962-1 must be completed providing for the release of proceeds for essential family living and farm expenses. Such releases must be provided during any administrative appeal proceedings and continue until such accounts are accelerated. These borrowers will not be sent Form FmHA 1924-25 or 1924-26 because of a monetary default until directed by the Administrator to do so.

For those borrowers on Finance Office Report Code 540 whose accounts indicate one or more loans with no payments ever made, the County Office will determine aging of the account by reviewing the case file and classifying the borrower as to the year the first installment was due and issue the appropriate notice as set forth in this AN.

Borrowers who were sent *both* the "Predetermination" package *and* an acceleration notice before October 20, 1984, will be sent no notices or letters of any kind. You should proceed to liquidate these cases, in consultation with OGC.

Attachments: Section 1962.49(c)(1), Section 1965, Section 1962.47, Exhibit A, Exhibit B.

Question. What is your best estimate of the number of FmHA borrowers who will be forced to liquidate or be subject to foreclosure this year?

Answer. The Agency cannot predict how many delinquent and problem loans eventually will be settled through adverse action. Each borrower's financial situation will be carefully evaluated, on a case-by-case basis, using the detailed guidelines set forth in the regulations. Until that is accomplished, there can be no realistic assumptions on which to base even broad estimates.

As of December 31, 1985, FmHA has 65,893 delinquent borrowers. Those borrowers who have not paid on an account since December 31, 1982, is estimated to be 27,000.

Question. Loan losses to FmHA have doubled between FY 1984 and 1985 from a total of $187,347,000 in 1984 to $354,486,000 in 1985. Do you expect this trend to continue and what would be the maximum loan loss to FmHA in the future?

Answer.[6] For FY 1984, FmHA losses in Farmer Program insured loans totaled $55,365,000, guaranteed loans losses totaled $11,240,000.

In FY 1985, FmHA Farmer Program insured losses totaled $147,351,000, guaranteed losses totaled $22,078,000.

FY 86 projection of losses for Farmer Program insured loans is $201,613,000 guaranteed losses are projected at $42,500,000.

FY 87 projection of losses to Farmer Program insured losses $236,866,000, guaranteed losses projected at $115,400,000.

Question. What is FmHA's policy on how long a farmer can obtain credit from FmHA? In other words, does FmHA have a firm graduation policy for its borrowers that makes it clear that they can obtain credit assistance for a specified period of time.

If no such graduation policy exists, do you believe one should exist? If so, how many years should FmHA assist a borrower before drawing the line at not becoming a permanent source of credit?

Would you please cite numbers on the success rate of graduating borrowers to private sources of credit?

Answer. FmHA does require graduation of its successful borrowers. The objective is to graduate borrowers to other credit as soon as they are able to do so.

Applicants and borrowers are advised at loan closing and periodically during routine visits and office visits that FmHA loans are a temporary source of credit, and that they will be requested to refinance their loans with other lenders when such credit is available.

We have a group of borrowers who are able to stay current on FmHA loans, but who are unable to develop the financial strength required by other lenders. In such cases, FmHA becomes the permanent source of credit. We have no specific time period that would require "drawing the line."

Question. Given some of the GAO numbers on the extent of delinquencies, do you feel that the eligibility requirements to obtain FmHA loan should be reconsidered?

Answer. Yes

Question. Of course, the FmHA properly provides credit to borrowers who would not be served by private sector lenders. However, I am interested in the differences in loan servicing policies that exist between FmHA and most commercial lenders. Would you please comment?

Answer. FmHA provides credit and management supervision to its borrowers. Commercial lenders do not as a general rule, work as closely with the family as does FmHA.

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[6] Information obtained from Budget Division on 2/5/86.

Question. What are you going to do with the farm land that FmHA may acquire if many of its existing borrowers go out of business?

Answer. On any farmland FmHA has inventory, a determination will be made if the sale of the property would have any adverse affect on the market value in the area. If selling would affect the land value, FmHA will lease it to family farmers where possible or to larger than family farmers when necessary.

Question. The GAO report indicates that on an average, FmHA borrowers reported a total cash-farm income of about $98,000 and operating expenses of $37,000 leaving $26,000 to pay family living expenses and debt repayment. Average debt repayment is $83,000 this leaving a cash short-fall of $56,000. FmHA clearly indicates projections are not realistic, as expenses should be around 85 to 90 percent of total case-farm income thus leaving cash short-fall of about $80,000. How do you justify making loans to these borrowers when they have no cash flow?

Answer. FmHA has been continuing limited assistance to seriously delinquent borrowers who have substantial cash flow short falls during the period of time the Agency was revising its servicing regulations to comply with Court mandated requirements.

This policy has been a major contributor to the statistical profile of an average FmHA borrower.

Along with the above-cited reasons, we do occasionally find evidence of unrealistic projections. This is caused largely by the lack of good farm records, both production and financial, and the Agency's antiquated Farm and Home Plan. Studies of this plan by a University Farm Managment Specialist indicated error rates as high as 300% when determining cash flows due to inadequacies of the plan requirements.

The CHAIRMAN. I do not want to cut anybody off. Rudy, would you and Dave like to have a couple minutes apiece in addition?

Senator BOSCHWITZ. I can just continue the hearing, if you need to go, Mr. Chairman. I will ask a couple of questions and I will not be more than 5, 6, or 7 minutes.

But I am just flabbergasted by the facts that—I had not read your report, and I will, but I notice that the nine Middle Western States where the corn and—you know—where all the action is supposed to be, that if you look at all the delinquent dollars in all of those States, add them all together, they do not equal what the delinquent dollars are in Georgia.

So that when we talk about problems with your portfolio, we ought to talk about Georgia, Mississippi, and Texas, those three States. Over 3 years, they are well over one-third of the over 3 year's total, and, throw in California, Louisiana, and Arkansas, you are up to half.

It is remarkable, that of your bad loans, the nine Middle Western States that make up the Corn Belt, do not have bad debts that equal the bad debts in the single State of Georgia. What happened there? Just an avalanche of debt? The banks decided to leave all farm lending and lay it all on you, or, President Carter has taken care of his constituency, or something?

Mr. NAYLOR. Senator, you said that, I did not, but I think if you would look at the records of the loans made, and the types of loans made, and the concentration of loans, particularly in 1978, 1979, and 1980, there was a very substantial growth in several of those Southern States. Particularly under the Economic Emergency Program in which loans were made which did not require repayment ability.

The standards that had applied to the Farmers Home Program, historically, simply did not apply to that particular kind of loan, or to the disaster loans.

Senator BOSCHWITZ. Are things tougher in the Southeast than they are in the Middle West?

The **Chairman**. No, you just had a President from the Southeast.

Senator **Boschwitz**. You mean that I should have supported Mondale? I could have bailed out the whole State.

The **Chairman**. I must have missed something. Was Mondale ever President?

Senator **Boschwitz**. No, no, but should I have supported him, Mr. Chairman, if——

Mr. **Naylor**. I would also have to say, in fairness, that there were several years of severe weather conditions in the South at about that time also, so that it was certainly a factor in their emergency problems.

Senator **Boschwitz**. We had some, too. The majority of the $4.8 billion in delinquencies, as I pointed out in my first round of questions, those which are more than 3 years old, are in the Emergency Disaster Program.

What causes the emergency program to have that distinction? I would address that to either or both of you.

Mr. **Naylor**. I think perhaps we discussed it a little bit earlier. You have a loan being made, that, inherently, is a high-risk loan.

In our operating loan, in our real estate loan, you are making it on the basis of an income stream coming off the crops that are planted, and you expect they would be able to repay.

Senator **Boschwitz**. Yes. There, you are the lender of last resort.

Mr. **Naylor**. Exactly, but in the case of the disaster loan, that is not the case.

Senator **Boschwitz**. You are not the lender of last resort.

Mr. **Naylor**. Well, not only that, but you are making a loan into an environment where the income has already been lost. There is not any repayment ability, in effect, because the loan is being made to replace the income that was lost due to the disaster

Senator **Boschwitz**. But you are making the loan to a broader array of farmers who have suffered a disaster, that does not mean that they have even any other debt. That does not mean that——

Mr. **Naylor**. Conceivably that is the case, although, in the last few years, that has not been the case. It was not the case when the heaviest volume of those loans were made in 1978, 1979, 1980, and 1981, which are now 3 or more years delinquent.

You can just about take the calendar and figure where those loans came from. Many of those loans were made under provisions of the law that did not require repayment ability in the sense that we have traditionally had, so the loan at the outset was made without that requirement.

And then, as economic conditions deteriorated in the 1980's, those loans were made even more difficult to repay.

Mr. **Clark**. Could I add just one point there. Again, as a private banker in those days, when that was occurring, in my home State of California, it was almost like an entitlement program; that they demanded to have access to those low-interest loans, and we did, as an agency, go along with that demand, and I found it very disappointing, from the private bankers' point of view, that that was happening.

Senator **Boschwitz**. You know, the FmHA loan program, as I recall, in reading the history of these programs, was intended to be a temporary source of credit for farmers who could not get credit elsewhere.

But it seems to me that the sight of that has been lost somewhat. Do you see a significant number of borrowers who now can see the agency as a permanent source of subsidized credit, who make no realistic effort to graduate to private lenders?

Mr. CLARK. We do indeed, I think, need to speed up our graduation reviews. I do not think we have really done a good job over the past in pushing for graduation.

I think particularly this year, we need to look at our borrowers and see which ones are indeed qualified to go on to another lender.

I think if there is going to be pressure on our funds this year, we need to do that, and we are trying to implement that.

Senator BOSCHWITZ. I would agree with you, that since there will be pressure on your funds, surely, that you should seek to graduate them. As you say, it is a tough time but——

Mr. NAYLOR. Senator, may I add just a little bit more on that because you offered me an opportunity to do so. We proposed earlier this year, and discussed with Congress during the course of the farm bill—and I hope we can discuss it with Congress again—the opportunity, to have the first entry point into our program for a new borrower, to be through the use of a guaranteed program instead of a direct loan.

That I thought was a very reasonable approach to making this transition. That was not accepted at the time the farm bill was passed but I think it is something worth reviewing further.

It is the best means I know of to keep borrowers with their regular lenders, even when they are in difficulties, through use of these guarantees.

Senator BOSCHWITZ. Now the 27,000 or 37,000 farmers who have loans on which they have made no payments for 3 years, do you seek other possible borrowers who will simply assume or purchase them? Is there an assumption, a possibility? Let us say that Mr. Clark has not made payments, and I come along now and I will take over his loan. What the heck, they are at low rates, and so forth, fairly well leveraged, and leveraging is the thing to do these days, even though there is somewhat more care than there was in the 1970's. Are you able to substitute people and improve your position?

Mr. NAYLOR. It is not easy to do. There are a number of restrictions within the farm bill, even this farm bill, on our ability to do that. The process that has to be gone through, who can assume the loans, who cannot; an ineligible borrower cannot assume the subsidized rate, and, the emphasis on who we can even offer the property to.

It has become probably too difficult a process. I hope that we will review this further with the Congress, and then look for some easier ways to deal with some of these problem cases that you allude to.

Senator BOSCHWITZ. Let me ask a final question, if I may, and that is, what do you see the solution with respect to the four or five largest States, where these 3-year delinquencies are located, which would be in Georgia, the second one would be Texas, the third one would be Mississippi? You know, what is maddening about that is, when we were dealing with the Farm Credit System, the Farm Credit System in those areas is very nice and healthy. They were lowering their rates. They were objecting to taking their capital out of the Farm Credit System because some of their capital might go to Spokane, or Omaha, or St. Paul, or wherever. And what appears to have happened is all their bad loans were deposited on your doorsteps. But what can we do in the four or five States: No.1, Georgia; No. 2, Texas; No. 3, Mississippi; No. 4, California; No. 5 would be Louisiana; then Arkansas.

Mr. Naylor. Senator, in this last round of farm legislation, you did give us some additional new tools, which the Senate committee took the lead in helping us develop.

One of those we call the homestead provision, which we intend to implement, which makes it possible for borrowers who cannot succeed any longer in farming operations to retain control of their homes, and to seek off-farm employment within the immediate community.

Most already have that kind of employment but need to resolve their debt load. There is also a timber provision——

Senator Boschwitz. And as you pointed out earlier, in those areas there is greater opportunity——

Mr. Naylor. That is correct.

Senator Boschwitz [continuing]. For that off-farm employment than there is, for instance——

Mr. Naylor. That is correct. In fact it is quite typical. In most cases you would find they have off-farm income in addition to the farm income, unlike my State, where that is not so common. In addition to that——

Senator Boschwitz. They still cannot make any payment——

Mr. Naylor. Well, the debt load is too heavy, particularly where they were either on their own, or persuaded to take some of these very large loans in the late 1970's, which were well beyond the capacity of the farm to repay.

There is also a timber provision in the new farm bill which predominantly deals with the Southeast, quite frankly, because it is aimed at softwood timber. It also provides another alternative to an operator under severe stress to work out of some of those very worse cases.

So you did provide us some new tools to deal with that. We are also looking for other options that we may be able to do by regulation as well as legislation.

Senator Boschwitz. The guaranteed loan losses were about $1 million in 1976, now up to about $20 million, small in conjunction, or when you talk about these others, but we have certainly increased the exposure there.

What is the trend going to be there, I would say to Mr. Clark, or yourself?

Mr. Clark. Obviously that will continue as we process our programs and push them into the guaranteed sector. Obviously, those losses are going to go up, but I must tell you, my feeling as a banker says that they are going to be much less than they would have been, had we booked them directly through our insured programs. So it is the way to go, and I think that we can do a better job by going the guaranteed route.

Senator BOSCHWITZ. And utilizing the banking system?

Mr. CLARK. Absolutely

Senator BOSCHWITZ. Well, I am pleased to hear that. I think that that is a good way to go in general. I would support that approach. Thank you.

The CHAIRMAN. Thank you, Rudy. Well, gentlemen, again I thank you, but if it has been said at all, it has been said only inferentially here this morning. That a lot of this problem arose because of unrealistically high subsidies.

Farmers were encouraged to get into production that they had no business getting into, and, in the Southeast, for example, you mentioned Georgia. There are many farmers down there growing winter wheat, and maybe they have been successful at it; maybe not. But I guess the most cruel thing that can be done to a farmer—and we all love them; my folks came off of a farm—is to dangle before them the false prospect that they can make it when the facts indicate otherwise. And that is the reason Senator Boschwitz, and some of the rest of us were just so insistent that we get a realistic farm program, and a farm bill last year. On a scale of 1 to 10, I would rate it 5 or 6.

I wish we could have done more in terms of orienting it to reality, but we made some pretty good strides. Gentlemen, I thank you for coming, and for being patient while we went to vote, and during the questioning, and thank you, Senator Boschwitz. We stand adjourned.

[Whereupon, at 12:50 p.m., the committee adjourned, subject to the call of the Chair.]

APPENDIX

A STATEMENT OF HONORABLE PAULA HAWKINS
A U.S. SENATOR FROM FLORIDA

Mr. Chairman, I am exceedingly pleased that you have agreed to hold this hearing on the Farmers Home Administration action to provide for the servicing of its delinquent loans. It is high time that we set the record straight as to the Farmers Home Administration's policies with regard to borrowers who are delinquent in the repayment of their loans.

I am also pleased that we will have an opportunity to question representatives of the Government Accounting Office about the findings of the two reports they are releasing today. The first of these provides a comprehensive review of FmHA loan program debt, delinquencies, and loan losses. The second report gives a broad overview of the financial and general characteristic of FmHA farm loan program borrowers.

The information included in these reports draws a very clear picture of the situation among FmHA borrowers. For many the situation is desperate.

Unfortunately, these reports also indicate the difficult position the government is now in because of its role as the lender of last resort. Required by law to serve farmers who are the highest risks, FmHA is also obligated to protect the taxpayers' interest. This is a difficult tightrope to walk. It may be a tightrope that is at last stretched too tight. If the tightrope snaps--both FmHA borrowers and the taxpayers will be the unhappy victims.

Fortunately, both of these reports make the long term impact of Department of Agriculture credit policy clear. There is no doubt that many of today's farm credit woes are the direct result of the large amounts of inexpensive credit that was made available in the late 1970s.

Throughout debate on the Farm Bill discussion centered on the change that is overcoming many of our rural communities. As we face this change in structure of agriculture, in Federal agricultural policy, and in the credit delivery system available to our nation's farmers, it is incumbent on us to look at the past to prepare for the future. As I reviewed the testimony prepared by the General Accounting Office for today's hearing, one table and its accompanying graph kept jumping out at me.

From December 31, 1978 to December 31, 1980, FmHA farm debt almost doubled. During that three year period FmHA farm debt climbed from 9.9 billion dollars to 19.5 billion dollars.

In comparison, all other farm debt grew from 131.2 billion dollars to 162.9 billion dollars over the same three year period.

Expressed in other terms, non-government financed farm debt grew by 24 percent over a three year period while government financed farm debt grew by 96 percent. Clearly, the government was pursuing credit policies out of line with those pursued by private lenders.

Less than eight weeks ago the Senate was struggling to pass legislation to assist the Farm Credit System and its borrowers to adjust to changing economic conditions. We were repeatedly told that a significant part of the Farm Credit System's problems were due to large outstanding debts incurred by System borrowers during the high inflation seventies. Today, discussion continues among Senators about the likelihood that the government will be asked to provide financial assistance to commercial agricultural banks with loan problems generated by the same cause. Yet, during the late 1970s, these private lenders increased their outstanding debt at only one-quarter of the rate that the government made new credit available.

Prudent observers will surely ask, "What could have caused the Federal government to extend such massive sums of money to farmers who, by definition, fall into the highest risk category?"

Compassionate individuals will surely recognize the harm the policies of the late 1970s have heaped on American farm families.

This report from GAO gives us fresh hard data to consider as we try to make policy during the coming months. I hope that after more close examination the information in these reports will help us avoid the mistakes of the past and plan well for the future. I look forward to the testimony of today's witnesses.

STATEMENT OF HONORABLE MITCH McCONNELL
A U.S. SENATOR FROM KENTUCKY

Mr. Chairman, when I first was advised of the new Farmers Home Administration loan activities, I must candidly admit that I was very skeptical. After all, FmHA is the "lender of last resort" and if wholesale foreclosures were going to be the order of the day I was not sure these new lending policies were going to save very many farmers. This should be, as you know Mr. Chairman, a time of forbearance in light of the terrible economic crisis facing agriculture.

How surprised I was when I put down the newspaper accounts and took a closer look at how the new program would actually work! In fact, the word "foreclosure" is only mentioned once in the 7 page package sent to delinquent FmHA borrowers. I may be in the distinct minority here, but I want to commend the Farmers Home Administration for finally carrying out its historical mandate to serve those farmers who can't find credit elsewhere.

The delinquency rate for the Kentucky Farmers Home Administration is the lowest in the nation--less than 10 percent. And FmHA is not a small percentage lender. In fact, its loan volume for farm loans is nearly equal to that of the Federal Land Bank. The folks in the FmHA Office in Lexington, Kentucky must be doing something right although I suspect the diverse Kentucky agricultural economy has something to do with it. But just maybe the way Kentucky has been managing its loans might have something to do with it as well.

Mr. Chairman, some may view these new regulations as an undue harassment to borrowers. However, I think we need to keep something in mind here. FmHA borrowers do have an obligation to repay the money they've borrowed from the taxpayers. In turn, FmHA has an obligation to do a better job of managing the loan portfolios of its borrowers to prevent them from becoming problem accounts. No matter how small the debt, if a farmer hasn't made some kind of payment in over a year, he's got a problem. To sweep the problem under the rug or to do nothing is to ignore the simple fact that an individual borrower needs some direction which he hasn't been getting. It is my clear understanding that the intent of these new regulations is only to get farmers to stop by their local FmHA Office and talk about their problem. I view these new regulations as a step in the right direction.

It appears that both FmHA and FmHA borrowers now have the tools to work together to find the solution to an individual's problem. This adverserial relationship which has permeated the loan structure of USDA's lending arm and its borrowers must end. There are bugs in every system and there are doubtless bugs in this one. But, quite candidly, I feel that we must allow FmHA to begin to exercise some good loan management if we're ever going to get the house in order.

In my judgment, urging a borrower to come to town to talk about his Farmers Home loan is not too much to ask.

Thank you Mr. Chairman.

STATEMENT OF HONORABLE ALAN J. DIXON
A U.S. SENATOR FROM ILLINOIS

Mr. Chairman, I want to commend you for calling this hearing on Farmers Home Administration regulations regarding loan servicing.

The recent decisions by the Farmers Home Administration concerning delinquent loans have created much anxiety among farmers in my State of Illinois. While I understand that the Farmers Home Administration has "softened" the notices it will send to delinquent borrowers, I am still concerned about the impact it will have on thousands of farmers. The threat of mass foreclosures is a serious one. At this time of great crisis in our agricultural sector, I believe that FmHA's policies should stress forbearance and compassion.

I am especially concerned that understaffed FmHA offices may not be able to give farmers ample opportunity to work out alternatives to foreclosure.

Mr. Chairman, I appreciate this opportunity to hear firsthand about the Farmers Home Administration policies regarding delinquent borrowers.

Thank you.

STATEMENT OF VANCE L. CLARK, ADMINISTRATOR, FARMERS HOME ADMINISTRATION, UNITED STATES DEPARTMENT OF AGRICULTURE

Mr. Chairman, members of the Committee, I appreciate this opportunity to discuss the Farmers Home Administration's (FmHA) servicing regulations and notices to farm borrowers who are seriously behind in loan payments.

A brief background is necessary for a complete understanding of FmHA's goals and procedures.

For many years the Farmers Home Administration has been helping its farm borrowers who found themselves in economic trouble through no fault of their own. The agency routinely helped these farmers, when possible, through rescheduling or reamortizing loans and, in some cases, deferring part of their payments. The direction to the field to provide this assistance came from the national office through regulations and Administrative Notices.

In November 1983, the Federal District Court in Bismarck, North Dakota, issued a preliminary injunction, that later became permanent, which required Farmers Home to take steps to inform borrowers of the loan servicing alternatives available to them.

On November 30, 1984, the agency issued a proposed rule in the Federal Register to comply with the court ruling. Following the comment period and necessary adjustments, the regulations were issued as a final rule on November 1, 1985. The regulations, encompassing 63 pages of the Federal Register, covered all options and procedures in detail. Certainly, the agency made every effort to comply with the court's mandate to assure due process for every FmHA borrower.

The options are clearly spelled out in notices which are being sent to FmHA farm borrowers who were delinquent as of December 31, 1985. That date was selected because it is historically the lowest delinquency pint of the year. Most of the loan agreements call for an annual payment which is due on or about January 1. So most borrowers receiving the notices are at least one year delinquent.

The intent of the notice is to alert the farmer that he or she is seriously delinquent in loan payments and to spell out the various options available to help bring the account current.

Those options include:

- Rescheduling at regular rates and terms;
- Rescheduling of operating and farm ownership loans at limited resource rates and terms;
- Deferral of payments on principle or interest or both for 5 years;
- Subordination of FmHA's security interest to another lender;
- Restructuring by selling a portion of assets;
- Paying the account current; and
- Liquidating the account by selling, conveying to the Government or transferring the security.

Eligibility for these options is spelled out in detail in the regulations. Basically, to be eligible, borrowers must show that their delinquency is due to circumstances beyond their control; that they have lived up to all agreements made with FmHA; and that, with the extra assistance, they can eventually repay their loans.

All FmHA borrowers who have made no payments for three or more years as of December 31, 1985, or who have failed to properly account for security property, or who have abandoned the farming operation will be sent by registered mail a notice of "Intent to Take Adverse Action." It will cite the specific problem with the borrower's account and require the borrower to respond within 30 days.

When the borrower's response is received, an appointment is set up to review the borrower's financial condition. If one of the servicing options is approved, the notice to take adverse action is terminated. If the borrower fails to respond within 30 days or the servicing options cannot restructure the debt, FmHA will proceed to collect the account. Failure to respond within 30 days also forfeits any appeal rights.

Borrowers who are less than three years delinquent will receive a registered letter requiring them to contact the county office within 30 days to make an appointment to try to work out their loan problems. The same list of servicing options will be available to them. These borrowers will not receive a notice of intent to take adverse action.

The idea is to have the farmer and the FmHA county supervisor sit down together and develop a workout plan that yields a payment schedule that can be handled within the farmer's cash flow.

In addition to the options in the FmHA regulations, the Farm Bill contains a number of provisions that are presently being analyzed. They include the softwood timber section, conservation easements, and the homestead provisions.

Only after every option has been tried and failed will there be any move toward additional action. Even then, the borrower has a right to appeal FmHA's decisions.

It is expected, that with all the options and assistance available to FmHA borrowers, many will be able to work out of their financial difficulties. There are some who are so far behind that no amount of assistance can help. Of course, we cannot estimate the number of farmers that will be in that category until we have made every effort to help them work out a reasonable solution to their problems.

Mr. Chairman, this FmHA forbearance policy offers borrowers much more assistance than the policy of any other lending institution that I am aware of. The 5-year deferral option alone offers more relief to borrowers than typical state moratoriums which, at best, prohibit foreclosure for a year if the borrower can make interest payments.

I believe the Farmers Home Administration is making every possible effort to assist its seriously delinquent farmers under these regulations. Predictions by some of massive foreclosures under these regulations are unwarranted in my view.

We believe we are making a fair, reasonable and equitable attempt to provide every possible assistance to farmers who are behind in paying their debts to the government while, at the same time, carrying out our responsibilities to the Nation's taxpayers.

I'll try to answer any questions you or other members of the Committee may have.

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, DC 20548

January 2, 1986

The Honorable Jesse A. Helms
Chairman, Committee on Agriculture,
  Nutrition, and Forestry
United States Senate

Dear Mr. Chairman:

Your letter of September 6, 1986, expressed concern over the American farmers' growing reliance on the resources of the Farmers Home Administration (FmHA). You noted that FmHA's outstanding farm loan portfolio has increased from about $6 billion in 1978 billion in 1978 to almost $28 billion in 1985. With the Congress addressing the issue of financial stress in U.S. agriculture, including FmHA's future role in assisting additional farmers, you asked GAO to inform your Committee of the current financial condition of both FmHA borrowers and the farm loan portfolio. This report and another report entitled Farmers Home Administration: An Overview of Farmer Program Debt, Delinquencies, and Loan Losses (GA)/RCED-86-57BR, Jan. 1986) respond to your request.

FmHA's computerized data base, the Farmer Program Management Information System (FARMS), contains certain financial and general characteristics of borrowers, such as debt load and cash flow, the type and size of farm operations, and demographic data. FARMS, started in 1983, uses information obtained from FmHA loan documents on borrowers who have received loans for (1) farm ownership, (2) annual operating expenses, (3) emergency disaster losses, and (4) soil and water development and conservation. Although FARMS does have some limitations (see p. ??), it is the most complete source of financial information available on FmHA borrowers. FmHA said this information is representative of all FmHA farmer program borrowers on a national basis but is not projectable to individual states or counties.

This briefing report presents information on a total of 65,893 FmHA borrowers who received 117,366 farm loans during 1983 and 1984 (about 53 percent of all farm loans made during that period). The first section of the report provides information on borrower assets and liabilities, debt-to-asset ratios, and equity positions. The second section discusses the cash flow position of the borrowers; the third section provides general characteristics of borrowers including farm type, size, and demographic data. Section four of the report is our observations related to our analyses of the FARMS data, and section five provides details on the scope, methodology, and data limitations of our work.

FmHA acts as the federal government's "lender of last resort" and, as such, is expected to serve farmers under a high degree of financial stress. Specifically, for borrowers in the FARMS data base we found that

-- The average borrower had a debt-to-asset ratio of 83 percent. Twenty percent of the borrowers had debt-to-asset ratios of over 100 percent, which means they are technically insolvent. An additional 31 percent of the borrowers had debt-to-asset ratios between 70 and 99 percent, which means they are having extreme financial problems. (See Table 1.2)

-- In the first half of 1985, FmHA made new loans to 7,213 technically insolvent borrowers for about $763 million while 12,047 borrowers having extreme financial problems received new loans for another $1.2 billion. (See Table 1.5)

-- The average borrower had a yearly negative cash flow of about $56,000. Fifteen percent of the borrowers had a positive cash flow. (See Tables 2.1 and 2.2)

FmHA is faced with the dilemma of providing credit to high-risk farmers while also protecting the government's financial interest. To assist farmers in difficult economic times, FmHA revised its servicing policy in February 1982 to allow borrowers to obtain additional farm loans without considering the borrowers' ability to repay prior debts. This policy allowed many farmers to stay in business. However, it also resulted in FmHA's lending money to many farmers who had limited ability to repay those loans.

As of June 30, 1985, FARMS borrowers owed a total of $8.1 billion in FmHA farm loans of which $5.1 billion was owed by borrowers in extreme financial difficulty or technical insolvency. FmHA stated that the FARMS data are representative of the financial condition of all its farm borrowers and as such estimated that over $14 billion of its $28 billion farm loan portfolio is owed by borrowers in extreme financial difficulty and thus in jeopardy of default.

With more of its farm loan portfolio becoming at risk, FmHA again revised its servicing policy in November 1985. This new, more restrictive policy requires a borrower to be current on loan payments before additional credit will be provided.

We did not test the validity of the FARMS data base. We did obtain agency comments on the results of our work. FmHA officials agreed with the information contained in the report, and the comments provided have been incorporated where appropriate.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after its issue date. At that time we will send copies to the Secretary of Agriculture, the Administrator of the Farmers Home Administration, the Director of the Office of Management and Budget, and other interested parties. If you have additional questions or if we can be of further assistance on this issue, please contact me on (202) 275-5138.

Sincerely,

Brian P. Crowley
Senior Associate Director

Table 1.1

Statement of Assets and Liabilities for FARMS Borrowers[a]

	Average	Median	Number of borrowers
Property owned/assets			
Real estate	$181,900	$135,000	52,109
Livestock	39,400	25,000	44,928
Machinery and equipment	58,000	40,000	63,033
Personal property	33,600	20,000	63,432
Total	$262,700	$190,000	64,869
Debts owed/liabilities			
Liens on real estate	$125,400	$ 65,000	48,664
Liens on chattel and crops	88,800	60,000	59,681
Judgments	21,300	100	9,149
Taxes	2,300	600	18,676
Other debt	14,000	5,000	46,015
Total	$193,700	$135,000	63,406
Equity	$73,400	$40,000	63,288[b]
Debt-to-asset ratio	83%	70%	63,288[b]

[a] The totals are not equal to the sum of their parts because figures were rounded and not all data elements applied to all borrowers.

[b] Of the 65,893 FARMS borrowers analyzed, 63,288 reported sufficient data to compute a debt-to-asset ratio and equity position.

Source: GAO analysis of 1983 and 1984 FARMS data.

Statement of Assets and Liabilities

A number of different ways exist to determine the financial position of farmers. One measure is a statement of assets and liabilities that contrasts the amount of money the farmer has invested to the amount owed creditors. The FARMS data indicates that real estate represents the major component of the borrower's assets. The next largest asset group is machinery and equipment. Liens on real estate represent the largest liability followed by liens on chattel and crops.

As will be shown in a later section of this report, FmHA's principal loan activity occurs in the areas of farm ownership (i.e. real estate) and annual operating loans. Normally, farm ownership loans are secured by real estate liens while operating loans are secured by liens on chattel and crops.

Two commonly used measures to summarize a borrower's financial position are the debt-to-asset ratio and equity (net worth) position. The debt-to-asset ratio, which compares the value of a farmer's assets to the amount of money owed to creditors, is one of the primary measures to determine whether a borrower will have cash flow difficulties. Equity represents the net worth of the farm operation; or stated differently, equity is the value of property owned above the amount of debt associated with it.

As shown in table 1.1, the average debt-to-asset ratio for 63,288 FARMS borrowers was 83 percent. The average equity position of the FARMS borrowers was a positive $73,400. A positive equity indicates that the borrower could obtain cash by selling some assets or by using the equity as collateral for additional borrowing.

Because FmHA provides credit to many different types of borrowers, all FmHA requests for information do not apply to all borrowers. In addition, responses that are provided can vary widely depending on the type and size of the borrower's farm operation. This variance can distort an arithmatic average, so table 1.1 also provides the median values for responding borrowers. The median value is the point at which half of the borrowers had responses of greater than the value and half of the borrowers had responses less than the value. For example, table 1.1 shows that the median value for livestock was $25,000. This means that half of the 44,928 borrowers who reported that they owned livestock responded that the livestock's value exceeded $25,000 and half of the responding borrowers had livestock valued at less than $25,000. The average value of livestock for all responding borrowers was $39,400.

Further analyses of a borrower's financial position, as shown by the debt-to-asset ratio and equity position, is provided in tables 1.2 through 1.6.

Debt-to-Asset Ratio

The debt-to-asset ratio indicates the farm's overall financial soundness and risk-bearing ability. The Department of Agriculture's (USDA) Economic Research Service (ERS) Information Bulletin Number 495, dated July 1985, segregates debt-to-asset ratios into four categories.

Under 40 percent. Generally few financial problems and very strong net worth (no apparent financial problems).

40-69 percent. Problems meeting principal repayment but adequate net worth (serious financial problems).

70-99 percent. Problems meeting principal repayment and current interest due with declining net worth (extreme financial problems).

100 percent or more. Severe problems meeting principal and interest commitments. The farms are technically insolvent and sale of the farm's assets would not be sufficient to retire its debts (technically insolvent).

The ERS report states that at current prices, farming costs, and asset values, most farms start having difficulties meeting principal repayment commitments at debt-to-asset ratios of around 40 percent. Above 70 percent, farmers generally have problems meeting their interest and principal repayment commitments. With debt-to-asset ratios above 70 percent, many farms start sliding toward insolvency. The final critical point is insolvency where the total debts of the farm exceed the total value of owned assets. At this point, a farm generally cannot meet either interests or principal payments; and the value of assets, if sold, would not be enough to retire the debts.

Table 1.2 shows that 20 percent of the FARMS borrowers are technically insolvent. In contrast, USDA reported in January 1985 that about 3 percent of all farmers in the United States had debt-to-asset ratios of over 100 percent. An additional 31 percent of the FARMS borrowers are having extreme financial problems with debt-to-asset ratios of between 70 and 99 percent while USDA classified 7 percent of all U.S. farmers in that category.

Table 1.3 shows that when classified by cash farm sales, all categories of FARMS borrowers are, on average, experiencing extreme financial problems.

Table 1.2

FARMS Borrowers' Debt-to-Asset Ratio

Financial status of borrower	Debt/asset ratio (percent)	Number of borrowers	Percent of borrowers
Technically insolvent	100 and over	12,448	20
Extreme financial problems	70 to 99	19,743	31
Serious financial problems	40 to 69	20,076	32
No apparent financial problems	under 40	11,021	17
Total		63,288	100

Table 1.3

FARMS Borrowers' Debt-to-Asset Ratio by Cash Farm Sales

Cash farm sales	Average debt/asset ratio	Number of borrowers	Percent of borrowers
$ 0 to $ 49,999	77	20,873	33
$ 50,000 to $499,999	86	41,813	66
$500,000 and over	95	602	1
Total	83	63,288	100

Source: GAO analysis of 1983 and 1984 FARMS data.

Total Loan Amount Outstanding on All FmHA Farm Loans Owed by FARMS Borrowers as of June 30, 1985

The FARMS data base does not contain specific information on all FmHA farm loans owed by a borrower. For example, loans made under FmHA's Economic Emergency program are not specifically identified in the FARMS system. To obtain information on the total number and value of FmHA farm loans owed by FARMS borrowers, we obtained a copy of FmHA's Master Borrower File as of June 30, 1985. This file is a computerized data base containing selected information that includes the type and value of all outstanding direct FmHA farm loans and the status of payments due on these loans. The Master Borrower File does not contain information on a borrower's assets, other liabilities, income, and expenses. This information is only collected by the FARMS system.

As shown by the difference in the number of borrowers in table 1.2 and table 1.4, not all FARMS borrowers were included on the Master Borrower File. For example, some 1983 and 1984 FARMS borrowers were out of business by June 1985.

Our analysis showed that 11,658 FARMS borrowers, classified as technically insolvent, owed about 61,000 loans with outstanding unpaid principal of over $2.2 billion. An additional 81,521 loans, with outstanding unpaid principal of about $2.9 billion, were owed by 18,488 FARMS borrowers classified as having extreme financial problems. Thus, in June 1985 FmHA had about 142,000 loans totaling over $5.1 billion outstanding to FARMS borrowers who were in extreme financial difficulty.

Table 1.4

Total Loan Amount Outstanding on All FmHA Farm Loans Owed by FARMS Borrowers as of June 30, 1985

Financial status of borrower	Debt/asset ratio (percent)	Number of borrowers	Number of loans	Loan amount outstanding (millions)
Technically insolvent	100 and over	11,658	61,082	$2,214
Extreme financial problems	70 to 99	18,488	81,521	2,910
Serious financial problems	40 to 69	18,723	68,796	2,143
No apparent financial problems	under 40	9,998	30,394	870
Total		58,867	241,793	$8,137

Source: GAO analysis of 1983 and 1984 FARMS data and FmHA's Master Borrower File as of June 30, 1985.

New Loans Made to FARMS Borrowers, January 1 through June 30, 1985

Table 1.5 provides a comparison of FARMS borrowers with FmHA's Master Borrower File data base as of June 30, 1985, and shows that 18,688 new loans totaling about $763 million were made to technically insolvent borrowers during the first 6 months of calendar year 1985. An additional 32,790 new loans, for $1,254 million, were made to borrowers with extreme financial problems. Loans made to these borrowers characterize the high risk nature of FmHA lending.

Table 1.5

New Loans Made to FARMS Borrowers, January 1 through June 30, 1985

Financial status of borrower	Debt/asset ratio (percent)	Number of borrowers	Number of new loans	Amount of loans (millions)
Technically insolvent	100 and over	7,213	18,668	$ 763
Extreme financial problems	70 to 99	12,047	32,790	1,254
Serious financial problems	40 to 69	11,179	27,399	963
No apparent financial problems	under 40	5,155	10,559	333
Total		35,594	89,416	$3,313

Source: GAO analysis of 1983 and 1984 FARMS data and FmHA's Master Borrower File as of June 30, 1985.

By statute, FmHA is directed to make loans primarily to family farmers who are unable to obtain credit from other lenders at reasonable rates and terms. Responding to the downturn in the agricultural economy during the early 1980's, FmHA, in February 1982, liberalized its loan servicing policy to allow borrowers to obtain additional (new) financing without showing the ability to repay prior loans. This policy revision allowed FmHA to continue with delinquent and problem loan borrowers, provided the following conditions were met:

(1) The borrower acted in good faith by demonstrating sincerity and honesty in meeting agreements and promises made with and to FmHA.

(2) The borrower had been unable to pay accounts as scheduled, due primarily to circumstances beyond his/her control.

(3) The borrower had applied the improvements and key management practices spelled out in the Farm and Home Plan (FmHA planning document prepared by the farmer to develop a farm budget) or identified in the cash flow schedules.

(4) The borrower had properly maintained chattel and real estate security and properly accounted for the sale of security, including crops, livestock, and livestock production.

(5) The borrower developed a farm budget, projecting realistic production, commodity prices, and family living and production expenses. The budget showed that all current production expenses, reasonable family living expenses, and accruing interest on current production loans could be repaid from the current planned income. Borrowers were not required to show that they could pay principal and interest on other loans.

In November 1985 FmHA issued a policy directive that revised its loan servicing policy toward delinquent and problem borrowers. The new policy is more restrictive, requiring a borrower to be current on loan payments before additional credit will be provided.

Equity Position of FARMS Borrowers

As stated previously equity represents the value of assets beyond the amount owed. Table 1.6 shows that the average equity of FARMS borrowers is about $73,400. However, 20 percent of the borrowers have a negative equity and an additional 8 percent have less than $10,000 equity.

As shown in the following tables, FARMS borrowers are experiencing significant yearly cash flow shortfalls, which will further undermine their future equity position.

Table 1.6

Equity Position of FARMS Borrowers

Equity category	Average within category	Borrowers within category	Percent
Negative equity			
-$500,001 or more	-$728,300	335	1
-$ 50,001 to -$500,000	- 277,100	4,691	7
-$ 10,001 to -$ 50,000	- 29,800	4,831	8
-$ 1 to -$ 10,000	- 4,600	2,573	4
Total		12,430	20
Positive equity			
$ 1 to $ 10,000	$ 5,100	5,143	8
$ 10,001 to $ 50,000	29,800	16,409	26
$ 50,001 to $500,000	269,900	27,911	44
$500,001 or more	699,300	1,395	2
Total		50,858	80
Total	$ 73,400	63,288	100

Source: GAO analysis of 1983 and 1984 FARMS data.

Cash Flow Statement for FARMS Borrowers

Cash flow statements provide information on the source of cash income, both farm and nonfarm, and indicate the farm's overall ability to pay current production expenses, service principal and interest payments on farm debt, and provide for family living needs. The cash flow measure used in table 2.1 is a short-run measure since it does not take into account depreciation of assets or a return on owner-operator components such as labor, land, and machinery.

Table 2.1 shows FARMS borrowers reported total cash farm income of about $98,000 and operating expenses of about $73,000, which result in a net cash farm income of about $26,00. After considering nonfarm income and family living expenses, the borrowers reported about $24,000 available to repay debts due of about $83,000, or a net cash shortfall of about $56,000.

Table 2.1

Cash Flow Statement for FARMS Borrowers[a]

	Average	Median	Number of borrowers
Crop income	$67,300	$45,000	55,899
+ Livestock income	53,500	30,000	44,235
+ Conservation payments & other farm income	9,000	5,000	23,536
= Total cash farm income	$98,300	$75,000	64,530
- Cash farm operating expenses	72,900	60,000	64,321
= Net cash farm income	$25,700	$20,000	64,298
+ Nonfarm income	12,000	10,000	46,833
= Total net cash income	$34,200	$25,000	64,692
- Cash family living expenses	11,000	15,000	63,130
= Net cash income	$23,500	$15,000	64,728
- Debt repayment due this year	83,300	55,000	61,932
= Cash surplus/ shortfall	-$56,000	-$30,000	64,930[b]

[a] The totals and subtotals are not equal to the sum of their parts because figures were rounded and not all data elements applied to all borrowers.

[b] Of the 65,893 FARMS borrowers analyzed, 64,930 reported sufficient data to compute a cash flow statement.

Source: GAO analysis of 1983 and 1984 FARMS data.

The data source in FARMS used to develop the cash flow statement was a planning document entitled the Farm and Home land. The plan is prepared by the farmer to develop a farm budget that projects production, commodity prices, and living expenses. FmHA officials noted that as a planning document used in the loan approval process, the data tend to be optimistic. As such, they believe that our analyses of cash farm operating expenses and cash family living expenses are conservative. They stated that more realistic estimates of farm operating expenses could be about 85 to 90 percent of total cash farm income and of family living expenses would be about $20,000. If these numbers are more accurate, the average cash shortfall of an FmHA farm borrower would increase by another $24,000 to about $80,000 per year.

In addition to average values, table 2.1 provides the median values for responding borrowers. The median value is the point at which half of the borrowers had responses greater than the value and half of the borrowers had responses less than the value. The median shows the variance in responses caused by the wide range of farm types and sizes serviced by FmHA.

Tables 2.2 through 2.5 provide further analyses of cash flow, including details on the number of FARMS borrowers with a cash surplus or shortfall, their nonfarm income, and annual debt repayment.

FARMS Borrowers' Cash Surplus or Shortfall

Table 2.2 shows that 85 percent of the FARMS borrowers providing sufficient data to make the calculation have a negative cash flow.

Table 2.2

FARMS Borrowers With a Cash Surplus or Cash Shortfall

	Cash surplus or shortfall	Number of borrowers	Percent of borrowers
Negative Cash Flow	-$100,001 or more	11,740	18
	-$ 50,001 to -$100,000	11,883	18
	-$ 10,001 to -$ 50,000	22,578	35
	-$ 1 to -$ 10,000	8,885	14
Total			85
Positive Cash Flow	$ 0 to $ 10,000	4,752	7
	$ 10,001 to $ 50,000	3,618	6
	$ 50,001 to $100,000	788	1
	$100,001 or more	686	1
Total			15
Total		64,930	100

Source: GAO analysis of 1983 and 1984 FARMS data.

FmHA officials stated that lending to farmers with a cash flow exceeding $50,000 probably took place under the emergency disaster loan program. Emergency disaster loans are made as a result of national disasters such as drought, floods, and hailstorms. Such loans are not restricted to family farmers who cannot get credit elsewhere.

FARMS Borrowers' Annual Debt Repayment

Table 2.3 shows that about one third of the 61,932 responding FARMS borrowers reported a debt repayment due of less than $30,000, while about 20 percent reported debt repayment due of $120,000 or more. The nature of this debt, that is who provided the loans and the terms and conditions of the loans, is not captured by the FARMS system. However, total debt repayment due is supposed to represent all of the borrower's debt, not just the FmHA portion.

Table 2.3

FARMS Borrowers' Annual Debt Repayment

Annual debt repayment due	Number of borrowers	Percent of borrowers
$ 0 to $ 29,999	19,370	31
$ 30,000 to $ 59,999	14,968	24
$ 60,000 to $ 89,999	9,253	15
$ 90,000 to $119,999	5,638	9
$120,000 or more	12,703	21
Total	61,932	100

Source: GAO analysis of 1983 and 1984 FARMS data.

Nonfarm Income for FARMS Borrowers

Farmers can improve their cash flow and sustain their operations by augmenting farm income with nonfarm income. Table 2.4 reports nonfarm income levels for FARMS Borrowers. About 53 percent of the 46,833 borrowers who reported nonfarm income had amounts of less than $10,000, while 2 percent reported nonfarm income of over $40,000.

Table 2.4

Amount of Nonfarm Income for FARMS Borrowers

Amount of nonfarm income	Number of borrowers	Percent of borrowers
$ 0 to $ 9,999	25,011	53
$10,000 to $19,999	14,443	31
$20,000 to $29,999	4,899	11
$30,000 to $39,999	1,358	3
$40,000 and over	1,122	2
Total	46,833	100

Source: GAO analysis of 1983 and 1984 FARMS data.

FmHA officials stated that lending to farmers with nonfarm income exceeding $40,000 probably took place under FmHA's emergency loan programs that are not restricted to family farmers who cannot get credit elsewhere. FmHA stated that for the most part, these borrowers were larger than family-size farmers.

FARMS Borrowers Classed by Cash Farm Sales

The family-size farm is the primary target classification for FmHA's farm loan programs. Family-size commercial farms are defined by ERS as having farm income of from $50,000 to $500,000. Table 2.5 shows that about two thirds of the 64,530 responding borrowers fit this definition.

Table 2.5

FARMS Borrowers Classed by Cash Farm Sales

Farm classification	Cash farm income/sales	Number of borrowers	Percent of borrowers
Small farms	$ 0 to $ 49,999	21,391	33
Medium farms	$ 50,000 to $499,999	42,529	66
Large farms	$500,000 and over	610	1
Total		64,530	100

Source: GAO analysis of 1983 and 1984 FARMS data.

Type of Loan Assistance to FARMS Borrowers, Calendar Years 1983 to 1984

Table 3.1 shows the number of loans received by FARMS borrowers during 1983 and 1984 by type of FmHA farmer loan program. During this period FARMS borrowers primarily received annual operating loans, which accounted for over 60 percent of the dollar value of all loans made to these borrowers. As previously noted, the FARMS system does not include specific information on economic emergency loans.

Table 3.1

Type of Loan Assistance Provided to FARMS Borrowers, Calendar Years 1983 and 1984

FmHA loan program	Number of loans by program	Dollar amount by program (millions)	Percent of total dollars
Farm ownership	10,075	$ 738	17
Operating	79,593	2,701	62
Emergency disaster	26,857	886	20
Soil and water	841	14	1
Total	117,366	$4,339	100

Source: GAO analysis of 1983 and 1984 FARMS data.

Average Amount of Individual Loans to FARMS Borrowers, Calendar Years 1983 and 1984

Table 3.2 shows that the average individual loan made to a FARMS borrower in calendar years 1983 and 1984 was about $37,000, with over half of the loans received being between $20,000 and $99,000.

Total Loans Made to Individual Farms Borrowers, Calendar Years 1983 and 1984

Since an individual borrower can obtain more than one loan, we added all the loans made to a FARMS borrower during 1983 and 1984 to determine the average amount of funds received. Table 3.3 shows that the average FARMS borrower received loans totaling about $67,500 during the period.

Table 3.2

Average Amount of Individual Loans to FARMS Borrowers, Calendar Years 1983 and 1984

Loan amounts	Number of loans	Average loan amount	Percent of loan dollars
$ 1 to $ 9,999	23,667	$ 5,634	20
$ 10,000 to $ 19,999	24,614	14,355	21
$ 20,000 to $ 99,999	62,505	46,044	53
$100,000 to $149,999	4,248	115,324	4
$150,000 and over	2,332	208,001	2
Total	117,366	$ 36,975	100

Source: GAO analysis of 1983 and 1984 FARMS data.

Table 3.3

Total Loans Made to Individual FARMS Borrowers, Calendar Years 1983 and 1984

Loan amounts	Number of borrowers	Average loan amount per borrower	Percent of borrowers
$ 1 to $ 9,999	7,448	$ 5,680	11
$ 10,000 to $ 19,999	8,699	14,584	14
$ 20,000 to $ 29,999	7,221	24,460	11
$ 30,000 to $ 49,999	10,786	38,931	17
$ 50,000 to $ 79,999	10,780	63,549	17
$ 80,000 to $139,999	11,426	103,350	18
$140,000 and over	7,952	214,783	12
Total	64,312[a]	$ 67,477	100

[a] Of the 65,893 FARMS borrowers analyzed, 64,312 reported data o the dollar amount of their loans.

Source: GAO analysis of 1983 and 1984 FARMS data.

Personal Characteristics of FARMS Borrowers

Table 3.4 shows that FARMS borrowers were primarily white, married, and non-veterans; considered themselves a member of a family unit; had a high school education; and considered their farming operation a sole proprietorship.

Table 3.4

Personal Characteristics of FARMS Borrowers

	Number of borrowers	Percent
RACE/ETHNIC		
White	62,285	95
Black	2,267	3
Amer. Ind.	430	1
Hispanic	524	1
Asian	108	-
No response	279	-
Total	65,893	100
BORROWER TYPE		
Individual	60,486	92
Partnership	2,019	3
Corporation	430	1
Cooperative	5	-
No response	2,953	4
Total	65,893	100
EDUCATION LEVEL		
Elementary (8 years or less)	6,911	11
High school (4 years or less)	37,246	57
College (6 years or less)	16,386	25
College (more than 6 years)	279	-
No response	5,071	7
Total	65,893	100

	Number of borrowers	Percent
SEX		
Male	17,556	27
Female	651	1
Family unit	45,623	69
Other	1,826	3
No response	237	-
Total	65,893	100
MARITAL STATUS		
Married	54,500	83
Separated	566	1
Unmarried	9,069	14
No response	1,758	2
Total	65,893	100
VETERAN		
Yes	14,826	23
No	49,300	75
No response	1,767	2
Total	65,893	100

Source: GAO analysis of 1983 and 1984 FARMS data.

Types of Farming Operations of FARMS Borrowers

Table 3.5 shows that about two thirds of the FARMS borrowers were engaged in crop production, while the remaining one third reported being engaged in livestock and dairy operations.

Tables 3.6 and 3.7 provide a further breakdown of the types of farms that the borrowers operated.

Table 3.5

Types of Farming Operations of FARMS Borrowers

Overall summary	Number of borrowers	Percent of borrowers
Agricultural production - crop	39,256	66
Agricultural production - livestock	20,337	34
No response	6,300	-
Total	65,893	100

Table 3.5--Continued

Agricultural Production - Crop		
Cash grains	17,157	29
Field crops, except cash grains	9,489	16
Vegetables and melons	394	1
Fruits and tree nuts	622	1
Horticultural specialties	147	-
General farms, primarily crop	11,447	19
Total	39,256	66

Agricultural production - livestock		
Livestock, except dairy, poultry, and animal specialties	7,587	13
Dairy	7,598	13
Poultry and eggs	684	1
Animal specialties	165	-
General farms, primarily livestock	4,303	7
Total	20,337	34

Table 3.6

Type of Farm Operation: Crop

	Number of borrowers	Percent of borrowers
Cash grains		
Wheat	2,932	5
Rice	589	1
Corn	4,079	7
Soybeans	7,010	12
Miscellaneous	2,547	4
Total	17,157	29
Field crops, except cash grains		
Cotton	3,802	6
Tobacco	4,011	7
Sugar crops	174	-
Irish potatoes	243	1
Miscellaneous	1,259	2
Total	9,489	16
Vegetables and melons		
Vegetables and melons	394	1
Fruits and tree nuts		
Berry crops	83	-
Grapes	59	-
Tree nuts	82	-
Citrus fruits	9	-
Deciduous tree fruits	322	-
Miscellaneous	67	-
Total	622	1
Horticultural specialties		
Ornamental floriculture and nursery products	98	-
Food crops grown under cover	12	-
Miscellaneous	37	-
Total	147	-
General farms, primarily crop		
General farms, primarily crop	11,447	19
Total	39,256	66

Source: GAO analysis of 1983 and 1984 FARMS data.

Table 3.7

Type of Farm Operation: Livestock

	Number of borrowers	Percent of borrowers
Livestock, except dairy, poultry, and animal specialties		
Beef cattle feedlots	401	1
Beef cattle except feedlots	3,731	6
Hogs	2,255	4
Sheep and goats	194	-
Miscellaneous	1,006	2
Total	7,587	13
Dairy		
Dairy farms	7,598	13
Poultry and eggs		
Broiler, fryer, and roaster chickens	412	-
Chicken eggs	142	-
Turkeys and turkey eggs	63	-
Poultry hatcheries	6	-
Miscellaneous	61	-
Total	684	1
Animal specialties		
Fur-bearing animals and rabbits	27	-
Horses and other equines	27	-
Miscellaneous	111	-
Total	165	-
General farms, primarily livestock		
General farms, primarily livestock	4,303	7
Total	20,337	34

Source: GAO analysis of 1983 and 1984 FARMS data.

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GAO Observations

FmHA is faced with the dilemma of providing credit to high-risk farmers while at the same time protecting the government's, and ultimately the taxpayers', financial interests.

By statute, FmHA is directed to make loans to family farmers who cannot obtain sufficient credit elsewhere to finance their actual needs at reasonable rates and terms. As such, it was expected that FmHA would provide financial assistance to high-risk borrowers. On the other hand, FmHA is also tasked to use generally accepted sound loan-making practices to ensure that its loans have a reasonable chance of being repaid or that sufficient collateral exists to have an adequately secured loan if the borrower defaults.

As agricultural economic conditions worsened in the early 1980's, FmHA found itself with loan requests from farmers who had limited loan repayment ability. In an effort to assist farmers who were dealing with difficult farm credit conditions, FmHA, in February

1982, revised its loan servicing policy to allow borrowers to obtain additional (new) financing without showing the ability to repay prior loans. This policy, which became known as the continuation policy, stated that FmHA would continue to work with present borrowers who, among other things, have a reasonable chance to repay any new loan.

In March 1983 the Department of Agriculture's Office of Inspector General (OIG) issued an audit report stating that FmHA loan-making policies had resulted in additional loans to borrowers of repaying current production loans. In responding to that report, the FmHA Administrator justified this continuation policy by stating

> "The Agency's objective in adopting the 1982 policy, and it continues to be the Agency's objective, was to continue with the vast majority of our borrowers and to spread out the number of cases requiring legal action or forced liquidation over a period of several years, taking action first on the most seriously delinquent and hopeless problem case borrowers. If the Agency had taken a firm stand against all its delinquent borrowers and had forced a large number of those borrowers out of business over a relatively short period of time, it would have driven down the value of real estate and chattel security for FmHA as well as other agricultural lenders. This would not only have caused a further downturn in the agricultural economy, but would also have aroused political concerns which might very well have resulted in legislation mandating the Agency to temporarily cease all foreclosure actions, provide moratoriums on loan payments, forgive principal and interest or mandate other unsound credit management policies. . . . We agree with OIG that the February 1982 policy has resulted in FmHA continuing with borrowers, in some cases, who are seriously delinquent and may not be able to work their way out of these financial problems. However, we believe the policy is within the legislative intent of the Consolidated Farm and Rural Development Act and is representative of the Agency's mission to sustain agricultural production and provide credit to farmers who are unable to finance their operations through commercial and private credit sources."

The result of FmHA's continuation policy is a farm loan portfolio that contains a large number of loans that are highly susceptible to default.

As shown in table 1.4, over half of the 63,288 FmHA FARMS borrowers included in our analyses had debt-to-asset ratios of 70 percent or greater, classifying them as having extreme financial problems. During the first 6 months of 1985, FmHA's continuation policy allowed over $2 billion to be loaned to about 19,000 of these borrowers. About $763 million of this amount constituted new loans made to over 7,000 technically insolvent borrowers. As of June 30, 1985, about 30,000 FARMS borrowers we analyzed were in extreme financial difficulty or technically insolvent. These borrowers had outstanding loans totaling more than $5.1 billion with $2.2 billion of that amount being owed by technically insolvent borrowers. These figures represent only a portion of the $28 billion farm loan portfolio outstanding to all FmHA farm borrowers as of June 30, 1985.

In September 1985 we showed the results of our analyses to officials of FmHA farmer loan programs. They concurred that the results of our work were accurate. Subsequently, in a November 1985 meeting of all state directors, FmHA presented information on debt-to-asset ratios that they projected to all 264,000 FmHA farmer loan program borrowers. The information was based on an FmHA analysis of the FARM's data base and concluded that 20 percent, or 52,000 farm borrowers, were technically insolvent. Another 33 percent, or about 86,000 borrowers, were categorized as in extreme financial difficulty with debt-to-asset ratios of between 70 and 99 percent. Of the remaining 126,000 borrowers, 31 percent were classified as having serious financial problems and 16 percent were considered to have no apparent financial problems.

FmHA's analyses, which included some 1985 data on the financial condition of its borrowers, produced generally the same results as our analyses. FmHA believes that the FARMS data is representative of the financial condition of all its farm borrowers and as such estimated that over $14 billion, or over half of its $28 billion farm loan portfolio, is in jeopardy of default.

On November 1, 1985, FmHA issued a directive that terminated the continuation policy. The new loan servicing policy requires borrowers to be current on loan payments before additional credit will be provided. FmHA stated that the new policy and related new regulations provide FmHA borrowers with clear, consistent, and predictable guidelines on how their loan accounts will be serviced by the agency. FmHA stated that the new servicing regulations let borrowers know, in advance, what servicing choices are available to them and how they may take advantage of these choices. FmHA added that borrowers who are delinquent on their loans as of December 31 of each year will receive a notice of their delinquency and the notice will advise them of the servicing choices available such as the rescheduling or deferral of payments due. However, if, after all servicing actions required by FmHA regulations have been considered and it has been determined that taking such action will not cure the borrower's default or delinquency, a borrower's loan account will be liquidated.

FmHA implemented its revised servicing policy in November 1985. As a result of this action, FmHA estimates that about 75,000 of its borrowers will receive a "Notice of Intent To Take Adverse Action" sometime in early 1986. This notice will allow borrowers to ask for servicing actions that can make them current on their loan payments and enable them to stay in business. However, FmHA believes that about 36,000 of these borrowers, who have not made a loan payment in over 3 years, have little chance of becoming current and most likely will fail.

As FmHA implements its more restrictive servicing policy, it is still faced with the dilemma of finding an appropriate balance between acting as the lender of last resort for farmers who cannot get credit elsewhere while at the same time protecting the government's financial interests through sound loan-making practices.

Objectives, Scope, and Methodology

As requested in your September 6, 1985, letter, our overall objective was to provide the Senate Committee on Agriculture, Nutrition, and Forestry with information on the financial condition of current FmHA farmer loan program borrowers. Specifically we agreed to provide, in briefing report format, information on borrower debt load, cash flow, and generally characteristics. As agreed with the Committee, we limited our review to analyses of existing data bases to provide as much valid information as possible by December 31, 1985.

The primary data source used in our review was FmHA's Farmer Program Information System, also known as the FARMS data base. We obtained a July 1, 1985, copy of this data base, which was started by FmHA in 1983. FARMS was designed to capture certain financial and other characteristics of FmHA's farm borrowers. We conducted our own computer analyses of the data and identified 65,893 individual borrowers who had received FmHA farm loans during 1983 and 1984. We sorted, tabulated, arrayed, and averaged financial information on these borrowers using various production, sales, debt, asset, and personal characteristics. Only 63,288 of the borrowers had reported sufficient information to make the debt-to-asset ratio computations. We did not analyze 1985 FARMS data because at the time of our review only limited information was available.

For a more complete picture of a borrower's financial condition and FmHA's total lending to FARMS borrowers, we also obtained a June 30, 1985, copy of FmHA's Master Borrower File data base. The Master Borrower File contains selected information on all active borrowers and loans in FmHA's total farm loan portfolio but no information on borrower assets, other liabilities, income, and expenses.

Data Limitations

The FARMS data base has three basic data limitations. The data base is not a statistical sample of all FmHA farm borrowers and thus is not statistically projectable to the nation. The FARMS system obtains its data input from FmHA county supervisors, but not all field offices have reported on all borrowers. However, because of the substantial number of borrowers reported in the system, FmHA officials believe the data is representative of all of its farm borrowers but not projectable to the individual state and county levels.

Second, FARMS was not designed to collect specific information on economic emergency loans, one of the five major FmHA farm loan programs, because the program expired in September 1984. The system does contain data on borrowers with (1) farm ownership, (2) operating, (3) emergency disaster, and (4) soil and water loans. The FARMS system does include the amount of economic emergency loan debt in data on total borrower debt without identifying specific sources of that overall debt. The economic emergency loan program represents $4.2 billion, or 15 percent of FmHA's entire farm loan portfolio, as of June 30, 1985.

Third, one of the major data sources for the FARMS system is FmHA's Farm and Home Plan. The Farm and Home Plan is a planning document used by the farmer to develop a farm budget that projects production, commodity prices, and family living and production expenses. Used as a planning document, the data tend to be optimistic as evidenced by FmHA's statement that our analysis of conservation. The result of this may be an optimistic presentation of a borrower's financial condition.

We conducted several comparisons of the FARMS data base with FmHA's Master Borrower File to determine how representative FARMS data were to total FmHA lending activities during 1983 and 1984.

-- The FARMS data contained at least one reported borrower in 87 percent of the counties in which FmHA made loans.

-- The 65,893 borrowers we identified from the FARMS data represented 56 percent of all borrowers who received loans of the type reported in FARMS during the time period.

-- The above borrowers received 53 percent of all loans made in the period.

-- The FARMS data accounted for 50 percent of the total dollars loaned during the time period.

The following tables provide details on the coverage of the FARMS data base.

Comparison of All Borrowers Who Received FmHA Loans to Those Reported in the FARMS Data Base

Table 5.1 shows the geographic coverage of the FARMS data base in relation to all FmHA farm loan program activity for calendar years 1983 and 1984. The table shows that the 65,893 borrowers in the FARMS system represented about 56 percent of the total FmHA borrowers for the period. In addition, one or more FARMS respondents were shown from 2,669 of the 3,056 counties (87 percent) where FmHA made farm program loans in calendar years 1983 and 1984.

Table 5.1

Comparison of All Borrowers Who Received FmHA Loans to Those Reported in the FARMS Data Base, Calendar Years 1983 and 1984

State	Borrowers from MBF	Borrowers from FARMS	State	Borrowers from MBF	Borrowers from FARMS
Alabama	2,353	1,009	New Mexico	564	275
Alaska	3	1	New York	2,156	718
Arizona	428	46	North Carolina	3,789	2,408
Arkansas	5,248	2,707	North Dakota	3,980	2,824
California	1,234	531	Ohio	2,457	900
Colorado	821	312	Oklahoma	3,946	2,247
Connecticut	162	72	Oregon	792	266
Delaware	124	77	Pennsylvania	1,678	858
Florida	1,087	203	Puerto Rico	918	210
Georgia	3,392	1,776	Rhode Island	34	15
Hawaii	109	59	South Carolina	1,827	753
Idaho	1,485	341	South Dakota	5,499	2,672
Illinois	6,280	4,536	Tennessee	3,965	2,136
Indiana	2,760	960	Texas	7,153	5,231
Iowa	7,921	5,301	Utah	508	264
Kansas	2,574	1,512	Vermont	478	305
Kentucky	5,825	4,136	Virgin Islands	7	3
Louisiana	6,176	2,558	Virginia	1,937	638
Maine	1,150	717	Washington	799	348
Maryland	601	296	West Virginia	801	417
			Wisconsin	3,663	1,783
Massachusetts	253	138	Wyoming	354	164
Michigan	2,490	1,219			
Minnesota	3,963	2,511			
Mississippi	4,824	1,767			
Missouri	6,218	4,631			
			Total	117,146	65,893
Montana	1,223	736			
Nebraska	2,636	1,687	Percent of total		56
Nevada	112	51			
New Hampshire	71	27	Total counties with FmHA loans	3,056	2,669
New Jersey	343	125			
			Percent of total		87%

Source: GAO analysis of 1983 and 1984 FARMS data and FmHA's Master Borrower File (MBF) as of December 31, 1984.

Table 5.2

Comparison of FARMS Data Coverage to All FmHA Farmer Program Loans, Calendar Years 1983 and 1984

	All FmHA loans[a]	FARMS data	FARMS as percent of all
Number of counties	3,056	2,669	86.7
Number of borrowers	117,146	65,893	56.2
Number of loans	220,957	117,366	53.1
Loan Amount (millions)	$8,736	$4,339	49.6

[a] To compare FARMS data on borrowers who received loans during 1983 and 1984 with all farm loan activity during the period, we used FmHA's Master Borrower File data base as of December 31, 1984. We also compared the information on only farm ownership, operating, emergency disaster, and soil and water loan programs from each data base because those are the only program loan types reported in FARMS.

Source: GAO analysis of 1983 and 1984 FARMS data and FmHA's Master Borrower File as of December 31, 1984.